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Supreme Court, U.S.
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No._____

IN THE

Supreme Court of the United States

October Term, 1991

MESA PETROLEUM CO., et al.,

Petitioners,

v.

DAVID COLAN and UNOCAL CORPORATION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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March 6, 1992

QUESTION PRESENTED

This case presents a single question under § 16(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78p(b), which provides that, for the purpose of preventing speculative abuse of inside information by corporate officers, directors and more-than-10% stockholders, any profit from such a person's "purchase" and "sale" of a corporation's equity securities within a period of less than six months is recoverable by the corporation:

Is an economically coerced exchange, pursuant to a corporation's recapitalization, of equity securities for debt securities by a more-than-10% stockholder (which never had access to inside information) an "unorthodox transaction" with no potential for speculative abuse of inside information and, therefore, not a "sale" for purposes of § 16(b) (as Petitioner Mesa claims and the District Court held); or is it instead a § 16(b) "sale" that may be matched against a market purchase of stock within the prior six months (as Respondent Unocal claims and the Court of Appeals held)?

PARTIES TO THE PROCEEDING

The petitioners are Mesa Petroleum Co., Mesa Southern Co., Mesa Asset Co., CY-41, Inc., and JACK-41, Inc.* The respondents are David Colan and Unocal Corporation.

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* The following information is provided pursuant to Rule 29.1 of this Court. Mesa Petroleum Co. (which was the parent company of Mesa Southern Co., which was in turn the parent company of Mesa Asset Co.) has been succeeded by Mesa Inc. Mesa Inc. is a publicly held corporation, the only non-wholly owned subsidiary of which is Clean Fuels, Inc. CY-41, Inc. and JACK-41, Inc. have no parent companies or subsidiaries.

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Petitioners Mesa Petroleum Co., Mesa Southern Co., Mesa Asset Co., CY-41, Inc., and JACK-41, Inc. (collectively, "Mesa") respectfully pray that a writ of certiorari issue to review the order and amended opinion of the United States Court of Appeals for the Ninth Circuit, entered in this proceeding on December 23, 1991.

OPINIONS BELOW

The opinion of the Court of Appeals for the Ninth Circuit, reversing the District Court's grant of summary judgment for Mesa and directing the District Court to grant summary judgment for Unocal, is to be reported at 951 F.2d 1512. App. 3a.[1] This opinion amended and superseded that court's previous opinion, reported at 941 F.2d 933. The opinion and order of the United States District Court for the Central District of California, entering summary judgment for Mesa and denying summary judgment for Unocal, is unreported. App. 36a.

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[1] References to the Appendix are cited "App. __a"

JURISDICTION

The decision of the Court of Appeals was originally entered on August 8, 1991. On December 23, 1991, the Court of Appeals denied a timely petition for rehearing and rejected a timely suggestion for rehearing en banc. App. 7a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This case involves the application and interpretation of § 16(b) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78p(b), which provides in pertinent part:

> (b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer . . . .

The phrase "beneficial owner" is defined in § 16(a) of the 1934 Act, 15 U.S.C. § 78p(a), as "[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any [registered] equity security. . . ." The full text of § 16(a) and (b) is set forth at App. 64a. With respect to the terms "purchase" and "sale," § 3(a) of the 1934 Act, 15 U.S.C. § 78c(a)(13), (14), provides:

> When used in this chapter, unless the context otherwise requires —
>
> . . . .
>
> (13) The terms "buy" and "purchase" each include any contract to buy, purchase, or otherwise acquire.
>
> (14) The terms "sale" and "sell" each include any contract to sell or otherwise dispose of.

STATEMENT OF THE CASE

This case is the final vestige of a 1985 contest for control of Unocal that involved a hostile tender offer by Mesa, a bitter public relations campaign, a proxy fight, acrimonious litigation in several courts and a highly coercive defensive recapitalization by Unocal that ended the contest.

In early 1985, Mesa acquired more than 10% of Unocal's common stock. From the start, Mesa's relationship with Unocal was characterized by "unmitigated hostility." App. 50a. At no time did Mesa have access to any inside information whatsoever about Unocal. In April 1985, Mesa commenced a cash tender offer for Unocal shares, seeking to acquire control of Unocal.

Unocal responded immediately by proposing a defensive recapitalization.[2] The recapitalization was structured as an exchange offer (the "Exchange Offer") of newly created Unocal bonds for about half of Unocal's outstanding shares of common stock. In form, each stockholder could decide whether or not to exchange his shares. But the economics were such that any stockholder who did not participate would suffer severe financial injury — an immediate reduction of about 40% in the value of his Unocal investment.[3] Unocal warned its stockholders of these conse-

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[2] A defensive recapitalization typically involves an exchange of cash or debt securities (or both) by the target company for its own common stock, with a commensurate increase in debt accompanied by liens on assets or other restrictive covenants, all intended to make the target company less desirable and to make the tender offeror abandon its efforts. *See* 1 A. Fleischer, *Tender Offers: Defenses, Responses, and Planning* 388.172-81 (Supp. 1987). A recapitalization can be effected by means of an exchange offer, a merger or stockholder-approved charter amendments. *Id.* at 388.180.

[3] The $72 in bonds that Unocal offered for each share of stock to be exchanged was far above the then-current stock value of $49 per share. It was generally anticipated by the trading markets, and specifically intended by Unocal, that this reallocation of value from Unocal equity to Unocal debt would instantly drive the post-transaction market value

quences in a prospectus that contained more than 100 printed pages of financial and other disclosures.

To make the Exchange Offer as lethal to Mesa as possible, Unocal provided that Mesa, alone among all its stockholders, would not be allowed to exchange any of its shares for bonds. Thus, if the Exchange Offer had been completed as originally structured, the value of Mesa's Unocal investment would have plummeted 40%.[4]

Mesa considered (and rejected) the possibility of seeking to mount a tender offer for the Unocal shares that would remain outstanding after the Exchange Offer.[5] Mesa filed actions in both federal and state court trying, unsuccessfully, to stop the Exchange Offer or to invalidate the provision excluding Mesa. Mesa's final challenge failed on May 17, 1985, when the Delaware Supreme Court ruled that Unocal could consummate the Exchange Offer and exclude Mesa. In light of the dire financial consequences of being left out of the Exchange Offer, Mesa

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of the remaining shares of stock down to about $30 per share, or almost 40% less than the pre-transaction $49 value. A stockholder who participated in the recapitalization would end up with a combination of (1) Unocal bonds (valued at $72 for each share he exchanged) plus (2) half of his original shares of Unocal stock (valued at an expected $30 per share) — yielding a "blended" value of about $51 per original share (i.e., ½ × $72 plus ½ × $30). (Unocal later reduced the exchange percentage to about one third.) The value of a non-participating stockholder's shares would fall immediately to about $30 per share.

[4] In Mesa's case, this would have been a decrease in value of about $450 million (i.e., a $19 per share decrease on 23.7 million shares).

[5] Although Mesa argued below that the record did not support (and indeed contradicted) the conclusion that the possibility of such a tender offer had in fact been realistic, Mesa does not seek review by this Court of the Ninth Circuit's conclusion that such an alternative was, as a factual matter, a viable "choice" available to Mesa. App. 24a-25a. *See* Part IV, *infra*, regarding the legal relevance of this "choice."

concluded that its only realistic alternative was to abandon its efforts to acquire Unocal in return for Unocal's granting it the right to participate in the Exchange Offer like all other stockholders. On May 20, 1985, Unocal agreed to let Mesa participate in the Exchange Offer, subject to Mesa's abandoning its tender offer and signing an onerous "standstill" agreement.[6] Accordingly, Mesa exchanged a portion of its Unocal common shares for Unocal bonds. Mesa later sold these bonds, which as debt securities were not subject to § 16(b), for cash.

In June 1986, David Colan, a Unocal stockholder, filed this case on behalf of Unocal in the District Court, invoking jurisdiction under § 27 of the 1934 Act, 15 U.S.C. § 78aa. Unocal, originally a nominal defendant, was subsequently realigned as a plaintiff.[7] The lawsuit seeks disgorgement under § 16(b) by Mesa to Unocal of alleged short-swing profits, plus pre-judgment interest, of about $150 million.

Mesa moved for summary judgment arguing, in reliance on *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973) (*"Kern County"* or *"Kern"*), that its exchange of Unocal stock for Unocal bonds in the economically coercive Exchange Offer was an unorthodox transaction with no possibility for speculative abuse of inside information and, therefore, not a "sale" for purposes of § 16(b). Unocal also moved for summary judgment, arguing that the exchange was a § 16(b) "sale." On April 10, 1990, the District Court granted Mesa's motion and denied Unocal's.

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[6] The standstill agreement prohibited Mesa from purchasing any additional Unocal stock for 25 years. In addition, since Mesa would still be Unocal's largest stockholder following the recapitalization (owning about the same percentage of outstanding shares it owned beforehand), Unocal used the agreement to impose strict controls on Mesa's ability to vote or sell the Unocal shares it retained.

[7] Unless the context otherwise requires, the term "Unocal" as used herein means both David Colan and Unocal Corporation.

On August 8, 1991, the Court of Appeals for the Ninth Circuit reversed the summary judgment for Mesa and directed the District Court to grant Unocal's cross-motion for summary judgment. On December 23, 1991, the Court of Appeals denied Mesa's petition for rehearing and rejected its suggestion for rehearing en banc.[8]

Concluding that Mesa's exchange was factually distinguishable from the transaction in *Kern County* because it was (1) not pursuant to a merger and (2) not an "involuntary" transaction, the Court of Appeals held that the exchange was a § 16(b) "sale." The Court of Appeals further stated that, as a result of its "determination that this exchange was not an 'unorthodox transaction,' we do not review the record to determine whether the Mesa Defendants had the opportunity to engage in the speculative abuse of inside information." App. 34a.[9]

On January 7, 1992, the Court of Appeals granted Mesa's motion for stay of the mandate. App. 63a.

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[8] If the decision below is allowed to stand, a trial will be required on issues not presented in this petition, including whether Mesa's March 1985 acquisition of 6.7 million Unocal shares (which increased Mesa's ownership from 9.7% to 13.6%) was effected in a single purchase or multiple purchases. *See Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232 (1976) (holding acquisition that results in ownership of more than 10% not a § 16(b) "purchase"). Whatever the outcome of those other issues might be, it would not affect whether the question presented here is worthy of certiorari, since it would not remedy the substantial confusion in the law concerning the important and recurring issue of "unorthodox transactions" under § 16(b), confusion that is exacerbated by the Court of Appeals' decision.

[9] Mesa does not seek review of the Court of Appeals' rejection of Mesa's argument regarding the nature of the proceedings before the District Court. Contrary to the suggestion in the Ninth Circuit's opinion, App. 17a, however, Mesa argued below that the District Court's judgment should have been affirmed on appeal whether reviewed on a summary judgment standard or on a "clearly erroneous" standard.

REASONS FOR GRANTING THE WRIT

The question presented concerns the proper application of this Court's analytical approach to "unorthodox transactions" under § 16(b), as set forth in Justice White's landmark opinion in *Kern County*. The Ninth Circuit's decision (which is supported by decisions of the Fifth, Seventh and Eleventh Circuits) conflicts with numerous decisions of the Second Circuit and with decisions of the Fourth, Sixth and Eighth Circuits.

Presented with facts strikingly parallel to those of *Kern County*, the Ninth Circuit nevertheless concluded that *Kern* was inapplicable both because Mesa exchanged securities in a recapitalization rather than a merger and because Mesa's exchange was "voluntary" rather than "involuntary."[10] In both respects, the Ninth Circuit's decision conflicts with decisions of the Second and other Circuits. If the Court does not grant the writ, the law regarding "unorthodox transactions," an important and recurring issue[11] under an important section[12] of the 1934 Act, will be left in substantial confusion.

On the broader issue of federal statutory construction, the Ninth Circuit has departed from the analytical approach employed by this Court and by the Second Circuit in recent cases, not involving unorthodox transactions, that have construed key statutory terms in §16(b) and other sections of the 1934 Act in context and in light of the purpose of the statutory provision.

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[10] In the course of denying the rationale of *Kern County*, the Ninth Circuit's opinion circumscribed *Kern* as merely a "fact-specific" case, App. 22a, and dismissed a frequently cited statement in *Kern* because this Court "did not cite any authority to support [it]." App. 32a-33a. *See* Part III, *infra*.

[11] *Kern County* is perhaps the most significant decision under §16(b) and has been cited in more than 100 cases.

[12] *Gollust v. Mendell*, 111 S. Ct. 2173, 2178 (1991) (describing §16(b) as "an important part of Congress' plan in the 1934 Act" to insure fair and honest trading markets).

Indeed, the conflicts presented here with Second Circuit decisions applying the unorthodox transaction approach and otherwise construing §16(b) terms are so numerous and direct that, without question, had this case been filed in that Circuit, the result would have been different.

If the decision below is allowed to stand, Mesa could be saddled with a judgment for $150 million, even though it could not possibly have engaged in the speculative abuse of inside information — the sole and specific evil that §16(b) is designed to prevent. Such a windfall for Unocal would serve no statutory or other legitimate purpose.

I. *Kern County's* Analytical Approach to §16(b)

Section 16(b) establishes a "flat rule"[13] that any profits realized by a statutory insider from the "purchase" and "sale" of an issuer's equity securities within six months are recoverable by the issuer. In sharp contrast with other provisions of the federal securities laws that deal with misuse or misstatement of information,[14] §16(b) requires no proof of scienter, reliance, causation, misrepresentation or materiality. Instead, if (1) a "purchase" and (2) a "sale" by (3) a statutory insider took place (4) within six months, §16(b) is applied "mechanically" to require "automatic" disgorgement of any profit. In most instances, therefore, application of §16(b) is simple, giving the rule its intended and stringent deterrent effect. *See generally* 5 L. Loss & J. Seligman, *Securities Regulation* 2331-36 (3d ed. 1990).

On the other hand, this "automatic" aspect of §16(b) does not eliminate the judicial function in deciding what the statute means. Courts long ago began to interpret the critical statutory terms

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[13] *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422 (1972).

[14] *E.g.*, Rule 10b-5 under §10(b) of the 1934 Act, 15 U.S.C. §78j(b), 17 C.F.R. §240.10b-5; Rule 14a-9 under §14(a) of the 1934 Act, 15 U.S.C. §78n(a), 17 C.F.R. §240.14a-9; §14(e) of the 1934 Act, 15 U.S.C. §78n(e).

"purchase" and "sale" in light of the statutory purpose unambiguously stated in §16(b) itself:

> For the purpose of preventing the *unfair use of information* which may have been *obtained* by such beneficial owner, director, or officer *by reason of his relationship to the issuer*. . . .

(emphasis added). Well before *Kern County*, the Ninth Circuit had concluded that §16(b)'s "exceedingly general" terms "purchase" and "sale" should be interpreted in light of the statute's purpose "to avoid purposeless harshness." *Blau v. Max Factor & Co.*, 342 F.2d 304, 306-07 (9th Cir.), *cert. denied*, 382 U.S. 892 (1965). As the Second Circuit put it, "[t]here is no rule so 'objective' ('automatic' would be a better word) that it does not require some mental effort in applying it on the part of the person or persons entrusted by law with its application." *Blau v. Lamb*, 363 F.2d 507, 520 (2d Cir. 1966) (construing §16(b)), *cert. denied*, 385 U.S. 1002 (1967).

This Court's decision in *Kern County* endorsed the 20-year trend of *Max Factor, Lamb* and other decisions. *See* 411 U.S. at 594 n.26 (citing five such cases with approval and endorsing their "pragmatic" approach).[15] *Kern*, like its predecessors, recognized that many "borderline" or "unorthodox" transactions — as opposed to "garden-variety" or "traditional cash-for-stock" transactions — could not possibly be used for the speculative abuse of inside information[16] that Congress sought to prevent and thus

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[15] For a discussion tracing the development of §16(b) law from the "simplistic," "mechanistic" approach of older cases through the unorthodox transaction cases ultimately endorsed in *Kern County*, see *Abrams v. Occidental Petroleum Corp.*, 450 F.2d 157, 162-63 (2d Cir. 1971) (Friendly, C.J.), *aff'd sub nom. Kern County*.

[16] "Inside information" about an issuer, of course, is nonpublic information about the business and affairs of the issuer, as distinguished from both public information about the issuer and nonpublic information that is not about the issuer (e.g., information about the objectives and plans of one of its stockholders). *See, e.g., Merrill Lynch, Pierce,*

should not be deemed "purchases" or "sales" within the scope of § 16(b). *Id.* at 591-95. The "unorthodox transaction" approach is the analytical framework within which transactions are scrutinized to determine whether they present an opportunity for speculative abuse of inside information:

> In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent — the realization of short-swing profits based upon access to inside information — thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits.

Id. at 594 (footnote omitted).

Consistent with the aspect of § 16(b)'s "flat rule" that truly is mechanical, the unorthodox transaction doctrine does not require the courts to address the often difficult fact issue of whether inside information was *in fact used* in connection with a purchase or sale. Instead, the doctrine holds that a transaction does not constitute a "purchase" or "sale" for § 16(b) purposes (whether or not it is a purchase or sale for other purposes) when — as here — the circumstances are such that the defendant *could not possibly* have used or benefitted from any inside information.[17] For to hold the nominal "insider" liable in the latter case would be punishment without purpose, which Congress (as evidenced by

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Fenner & Smith, Inc. v. Livingston, 566 F.2d 1119, 1122-23 (9th Cir. 1978); *Heublein, Inc. v. General Cinema Corp.,* 559 F.Supp. 692, 702-03 (S.D.N.Y.), *aff'd,* 722 F.2d 29 (2d Cir. 1983), *cert. denied,* 465 U.S. 1066 (1984).

[17] Reaching a conclusion to this effect, however, rarely requires a court to resolve disputed fact issues. Since the meaning of statutory terms is a question of law for the courts, the overwhelming majority of cases applying the unorthodox transaction approach under § 16(b), including *Kern* itself and almost all such cases cited herein, have been disposed of by summary judgment or at the pleading stage.

the statutory words) did not intend. *Cessante ratione legis, cessat et ipsa lex.*[18]

Not only has *Kern County* been the law for almost 20 years, but its analytical approach to interpreting the terms "purchase" and "sale" under § 16(b) is entirely consistent with recent decisions of this Court interpreting other statutory terms under other sections of the 1934 Act. These decisions have focused both on the statutory purpose of the particular section at issue and on the language of § 3(a) of the 1934 Act, which defines various terms used in the Act, including "purchase" and "sale,"[19] but introduces and explicitly qualifies every such term with the phrase "unless the *context* otherwise requires" (emphasis added). For example, in *Reves v. Ernst & Young,* 494 U.S. 56 (1990), construing another 1934 Act term, members of this Court observed that § 3(a)'s "context clause" leaves it to the judiciary to "harmonize . . . facially rigid terms . . . with the evident intent of Congress," *id.* at 75-76 (Stevens, J., concurring), and "to flesh out . . . 'context clause' exceptions." *Id.* at 81 (Rehnquist, C.J., concurring in part and dissenting in part). *See also Marine Bank v. Weaver,* 455 U.S. 551, 556 (1982) (noting that specified definitions may not apply if context otherwise requires). The Ninth Circuit's decision contravenes the analytical approach of these more recent decisions of this Court, as well as *Kern County*.

Similarly, the Ninth Circuit's decision conflicts with the analytical approach that the Second Circuit has applied in recent

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[18] *See, e.g., Blau v. Lamb,* 363 F.2d 507, 516 (2d Cir. 1966) (construing § 16(b); cited with approval in *Kern,* 411 U.S. at 594 n.26), *cert. denied,* 385 U.S. 1002 (1967).

[19] Section 3(a) does not, though, provide comprehensive definitions of these two terms. Virtually all other subsections of § 3(a) state that the term X *"means"* Y, but §§ 3(a)(13) ("purchase") and 3(a)(14)("sale") simply state that the term purchase (or sale) *"includes"* a contract to purchase or otherwise acquire (or to sell or otherwise dispose of). *See S.E.C. v. National Sec., Inc.,* 393 U.S. 453, 466 (1969) (describing § 3(a) as "for the most part unhelpful" in determining appropriate meanings of "purchase" and "sale" for purposes of § 10(b) of 1934 Act).

§ 16(b) cases interpreting terms other than "purchase" and "sale." *See Mendell v. Gollust,* 909 F.2d 724, 728 (2d Cir. 1990) ("We and most other courts have developed a 'pragmatic' approach, construing §16(b) in a manner that seems most consistent with Congress' purpose."), *aff'd,* 111 S.Ct. 2173 (1991); *C.R.A. Realty Corp. v. Crotty,* 878 F.2d 562, 566-67 (2d Cir. 1989) (using "functional" approach to construe term "officer" under §16(b) to include only those with "potential access to inside information"). *Cf. International Controls Corp. v. Vesco,* 490 F.2d 1334, 1343-45 (2d Cir.) (holding spin-off of securities a "sale" for § 10(b) purposes even though not a "sale" for § 16(b) purposes), *cert. denied,* 417 U.S. 932 (1974).

II. The Ninth Circuit's Decision Ignores the Close Factual Similarity Between This Case and *Kern County*

The undisputed facts of this case are overwhelmingly, indeed strikingly, parallel to those of *Kern County*. The factual differences, *see* App. 24a (characterizing this case as "factually distinguishable" from *Kern*), are immaterial in light of the fundamental rationale of *Kern*. In *Kern,* Occidental Petroleum had made a hostile tender offer for common stock of Old Kern. Like Mesa, Occidental was a true outsider (although it eventually owned 20% of Old Kern's stock) with absolutely no access to any inside information about Old Kern. *Kern County, passim.* Old Kern's management, like Unocal's, vigorously opposed the hostile offer. 411 U.S. at 598. To defeat Occidental's offer, Old Kern agreed to merge into Tenneco, with new preferred stock of Tenneco to be issued in exchange for Old Kern common stock. *Id.* at 599. The new Tenneco shares, like the Unocal bonds here, were to be freely tradeable.

When the merger agreement was announced, Occidental had several alternatives. It could have sold its Old Kern stock in the market (as Mesa could have done with its Unocal stock), but as this Court noted, that sale would have unquestionably resulted in §16(b) liability and thus was not a "realistic alternative." *Id.* at 599. Or Occidental could have made a higher tender offer for Old

Kern shares or otherwise attempted to frustrate Old Kern's defensive strategy with a proxy fight or legal challenge. Here, Mesa's legal challenges to Unocal's Exchange Offer failed, as had its earlier proxy fight. Mesa also considered (and rejected) the possibility of seeking to mount a tender offer for additional Unocal shares to compete with Unocal's Exchange Offer. After reviewing its alternatives, Occidental, like Mesa here, decided to abandon its takeover efforts and entered into settlement discussions with its adversary. *Id.* at 587.

In the concluding paragraph of its analysis, the Ninth Circuit emphasized that Mesa "voluntarily" sought to persuade Unocal to permit Mesa to participate in the Exchange Offer and "shrewdly calculated [its] options." App. 34a. But this does not distinguish Mesa's predicament from Occidental's; the Exchange Offer was engineered not by Mesa, but by Unocal for the very purpose of frustrating Mesa's efforts. *See* 411 U.S. at 599 ("That merger was not engineered by Occidental but was sought by Old Kern to frustrate" Occidental's takeover efforts). Once the Delaware Supreme Court had ruled against Mesa on May 17, 1985, Unocal had the absolute right to proceed with the Exchange Offer and to exclude Mesa from participating in it. The "negotiations" that Mesa and Unocal then had which resulted in the May 20, 1985 agreement permitting Mesa to participate concerned, not the terms of the Exchange Offer, but the terms of Mesa's capitulation. App. 11a-12a.

Moreover, in *Kern County*, Occidental "took ... steps to protect itself," 411 U.S. at 587, including voluntarily (and presumably "shrewdly") negotiating a separate option agreement with Tenneco, an arrangement available only to it and not to other Old Kern stockholders. *Id.* Upon signing the option agreement and receiving a substantial cash payment therefor, Occidental publicly announced that it supported the Old Kern-Tenneco merger, *id.* at 587-88, and even authorized its shares to be voted in favor of the transaction if its votes were needed to obtain the requisite majority. *Id.* at 616 (Douglas, J., dissenting).

Occidental's "plight" was hardly as "hapless" as the Ninth Circuit suggested. *See* App. 27a. Occidental's chief executive described his company's $17 million profit from his dealings with Old Kern and Tenneco as " 'not bad for two weeks' work.' " 411 U.S. at 617 n.23 (Douglas, J., dissenting). That Mesa's chief executive characterized the financial outcome of the transaction as a "victory" for Mesa, App. 27a, is equally irrelevant under the *Kern County* analysis.

Applying the unorthodox transaction analysis articulated in Part II of the opinion to these facts, *Kern County* held, in Part III, that Occidental's disposition of stock in the merger was not a "sale" for purposes of § 16(b) and, in Part IV, that its execution of the option agreement was not a § 16(b) "sale" either.[20]

Here, though, the Ninth Circuit ignored the factual parallels of this case with *Kern County*. Instead, it emphasized two differences: (1) the transaction here was a recapitalization in the form of an exchange offer, not a merger like the transaction at issue in

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[20] In holding that the execution of the option agreement (which by its terms related to the Tenneco stock Occidental would receive in the merger) did not constitute a § 16(b) "sale" of Occidental's Old Kern stock, the Court rejected two independent arguments advanced by the plaintiff. Most of Part IV of *Kern* deals with the Court's analysis under the unorthodox transaction approach:

> [W]e do not find in the execution of the Occidental-Tenneco option agreement a sufficient possibility for the speculative abuse of inside information with respect to Old Kern's affairs to warrant holding that the option agreement was itself a "sale" within the meaning of § 16(b).

411 U.S. at 601. The Court noted that even though Occidental wanted the option to avoid being a minority stockholder in Tenneco and Tenneco wanted to rid itself of a potentially troublesome minority stockholder, "[m]otivations like these do not smack of insider trading." *Id.* In the last paragraph of Part IV, the Court rejected the plaintiff's second argument, that the option was an option in form but a sale in fact. *Id.* at 603-04.

Part III of *Kern*, and (2) Mesa's disposition was "voluntary," because it "negotiated" the right to participate in the coercive Exchange Offer and because participation in an exchange offer (even an economically coercive exchange offer) requires a "voluntary" act on the part of the stockholder, whereas a merger does not.

III. The Ninth Circuit's Limitation of the Unorthodox Transaction Analysis to Mergers Conflicts with *Kern County* and with Decisions of the Second Circuit Applying That Analysis to Recapitalizations

The Court in *Kern County* did not attempt to articulate a precise, all-encompassing definition of the term "unorthodox" transaction (or its sometime substitute, "borderline" transaction). The term entered the § 16(b) lexicon simply as a short-hand device for differentiating transactions that are not "traditional cash-for-stock" transactions (the phrase used, e.g., in *Kern*, 411 U.S. at 593) or "garden-variety" transactions (the phrase used, e.g., in *Abrams v. Occidental Petroleum Corp.*, 450 F.2d 157, 162 (2d Cir. 1971), *aff'd sub nom. Kern County*).

Nevertheless, the Court did state in *Kern's* oft-cited footnote 24 that the term "unorthodox transaction" had been applied to "stock conversions, *exchanges pursuant to* mergers and *other corporate reorganizations*, stock reclassifications, and dealings in options, rights, and warrants." 411 U.S. at 593 n.24 (emphasis added) (citing 2 L. Loss, *Securities Regulation* 1069 (2d ed. 1961)[21]). Here, Unocal's Exchange Offer was a recapitalization — a recognized form of corporate reorganization[22] — of

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[21] This treatise, in turn, at 1069-72, discussed several of the early unorthodox transaction cases.

[22] *See, e.g.*, H. Henn & J. Alexander, *Laws of Corporations* § 386 at 1161-62 (3d ed. 1983) (noting that "term 'reorganization' . . . under state law is sometimes used as a synonym for recapitalization or reclassification of shares"); *Microdot, Inc. v. United States*, 728 F.2d 593 (2d Cir. 1984) (holding exchange offer of new debt securities for

Unocal, and thus squarely within the listing enumerated in *Kern's* footnote 24. Mesa's disposition in the Exchange Offer was obviously not a "garden-variety" or "traditional cash-for-stock" transaction.

The Ninth Circuit, however, confined *Kern County* to mergers. App. 29a. ("We conclude that the *facts in this matter* do not come within the holding of *Kern County* that an involuntary transaction that results from a *merger* is 'unorthodox.' " (emphasis added)).[23] Further, the Ninth Circuit dismissed the listing of unorthodox transactions in *Kern's* footnote 24 as irrelevant, stating that "the [Supreme] Court did not cite any authority to support [it]." App. 32a-33a.[24]

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a portion of corporation's common stock to be a "reorganization" under § 368 of the Internal Revenue Code and, more specifically, a "recapitalization" under § 368(a)(1)(E)).

[23] *See also, e.g.*, App. 24a (this case "factually distinguishable" from *Kern* because "Unocal did not merge"); App. 29a (*Kern* "simply held that an automatic exchange . . . pursuant to a merger" is not covered by §16(b)). The Ninth Circuit also stated that the "majority" of the transactions that have been considered unorthodox under the "exception announced" in *Kern County* were exchanges pursuant to mergers, App. 29a, thus implicitly acknowledging that other courts have applied *Kern* to non-merger transactions — and presumably suggesting that those "minority" courts went beyond *Kern*.

Even if the Ninth Circuit's decision is narrowly read as a holding that a recapitalization (and/or a tender offer or exchange offer) must always be a § 16(b) "sale," its holding conflicts with the rationale of *Kern*, and its numerous statements limiting *Kern* to mergers demonstrate that that holding was reached by applying a highly flawed approach to § 16(b) that conflicts with the approach mandated by *Kern*.

[24] In contrast, the Tenth Circuit has interpreted footnote 24 as a meaningful list of types of unorthodox transactions, and the Fifth and Seventh Circuits have (in dicta) characterized footnote 24 as a *nonexhaustive* listing thereof. *Morales v. Mapco, Inc.*, 541 F.2d 233, 235 (10th Cir. 1976) (holding transaction in warrants "unorthodox" because encompassed by footnote 24), *cert. denied*, 429 U.S. 1053

But it is plain that this Court in *Kern* did not limit the unorthodox transaction approach to mergers. Part IV of *Kern* applied the unorthodox transaction approach to the option granted by Occidental and concluded it was not a § 16(b) "sale." In Part II of the opinion, where the Court set forth an overview of its analytical approach before applying that approach to the two transactions at issue in Parts III and IV, the Court (1) included footnote 24, listing various types of transactions that had been deemed unorthodox; and (2) cited five earlier Court of Appeals decisions — *not one* of which involved a merger — as examples of the unorthodox transaction approach.[25]

In addition, the Ninth Circuit's decision conflicts with two decisions of the Second Circuit applying the unorthodox transaction approach to an exchange in a recapitalization. *Rothenberg v. United Brands Co.*, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶96,045 (S.D.N.Y.), *aff'd without opinion*, 573 F.2d 1295 (2d Cir. 1977);[26] and *Roberts v. Eaton*, 212 F.2d 82

(1977); *Texas Int'l Airlines v. National Airlines, Inc.*, 714 F.2d 533, 539 n.9 (5th Cir. 1983) (describing footnote 24 as a "nonexhaustive list"), *cert. denied*, 465 U.S. 1052 (1984); *Oliff v. Exchange Int'l Corp.*, 669 F.2d 1162, 1166 (7th Cir. 1980) (noting that *Kern* applies to " 'unorthodox,' or perhaps a broader class of 'borderline' transactions"; citing footnote 24), *cert. denied*, 450 U.S. 915 (1981).

[25] 411 U.S. at 594 n.26 (citing *Roberts v. Eaton*, 212 F.2d 82 (2d Cir.) (exchange of stock in recapitalization, which was initiated at behest of insider), *cert. denied*, 348 U.S. 827 (1954); *Ferraiolo v. Newman*, 259 F.2d 342 (6th Cir. 1958) (economically coerced conversion), *cert. denied*, 359 U.S. 927 (1959); *Blau v. Max Factor & Co.*, 342 F.2d 304 (9th Cir.) (voluntary exchange of one class of equity security for another), *cert. denied*, 382 U.S. 892 (1965); *Blau v. Lamb*, 363 F.2d 507 (2d Cir. 1966) (voluntary conversion of preferred stock into common), *cert. denied*, 385 U.S. 1002 (1967); and *Petteys v. Butler*, 367 F.2d 528 (8th Cir. 1966) (economically coerced conversion), *cert. denied*, 385 U.S. 1006 (1967)).

[26] The Second Circuit's holding in *Rothenberg* was dismissed by the Ninth Circuit on the ground that the exchange there did not result in a

(2d Cir.) (cited with approval in *Kern County*, 411 U.S. at 594 n.26), *cert. denied*, 348 U.S. 827 (1954).[27] Other courts have also, since *Kern*, applied its analysis to hold numerous types of transactions, other than mergers, to be unorthodox.[28]

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change in "either the character of the investment or the nature of the market risk assumed," in contrast to Mesa's exchange. App. 33a. But the district court opinion in *Rothenberg* said only that absent such a change, there was not a "sale." It did not say, as the Ninth Circuit concluded, that the presence of such a change ipso facto yields a "sale" within the scope of § 16(b). That proposition, in addition to being a non sequitur, would contravene *Kern County*, where Occidental exchanged common stock of one company for preferred stock of another.

[27] In *Roberts*, a combination of new preferred stock and new common stock was exchanged, pursuant to a plan approved by stockholder vote, for previously outstanding common stock. 212 F.2d at 83. The opinion termed the transaction a "reclassification," *id.*, a term now more commonly used for changes in the par value of an outstanding class of stock. *See, e.g.*, R. Balotti & J. Finkelstein, *Delaware Law of Corporations and Business Organizations* § 8.4 (2d ed. 1990).

[28] Other types of transactions that courts have labeled unorthodox under *Kern County* include: (1) cash tender offer — *Pier 1 Imports of Georgia, Inc. v. Wilson*, 529 F. Supp. 239, 243 (N.D.Tex. 1981); (2) recapitalization — *Hayes v. Sampson*, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,693 (S.D.N.Y. 1980); (3) exercise of options — *Pay Less Drug Stores v. Jewel Cos.*, 579 F. Supp. 1396, 1400-01 (N.D. Cal. 1984); (4) liquidation — *Bolton v. Gramlich*, 540 F. Supp. 822, 841 (S.D.N.Y. 1982); (5) exercise of stock appreciation rights — *Matas v. Siess*, 467 F. Supp. 217, 221 (S.D.N.Y. 1979); (6) sale of stock option rights — *Rosen v. Drisler*, 421 F. Supp. 1282, 1286 (S.D.N.Y. 1976); (7) open market transaction in warrants — *Morales v. Mapco, Inc.*, 541 F.2d 233, 235 (10th Cir. 1976), *cert. denied*, 429 U.S. 1053 (1977); (8) overissuance of shares — *Kay v. Scientex Corp.*, 719 F.2d 1009, 1012 (9th Cir. 1983); and (9) underwriting of warrants — *Portnoy v. Seligman & Latz, Inc.*, 516 F. Supp. 1188, 1197-98 (S.D.N.Y. 1981).

IV. The Circuits Are in Conflict over Both the Necessity for and the Meaning of "Involuntariness" as an Element of the *Kern County* Analysis

The Ninth Circuit's decision exacerbates a substantial conflict among the Circuits, including the Second Circuit, over the treatment of "involuntariness" under the unorthodox transaction analysis.

A. The Circuits Are in Conflict over Whether "Involuntariness" Is a Necessary Element Under *Kern County*

The Ninth Circuit concluded that the critical element of the *Kern County* analysis was the "involuntary" and "automatic" nature of the merger transaction at issue there. App. 24a, 29a. And indeed, the Court stated in *Kern* that "the involuntary nature of Occidental's exchange [in the merger], when coupled with the absence of the possibility of speculative abuse of inside information, convinces us that § 16(b) should not apply to transactions such as this one." 411 U.S. at 600.

Yet much of the *Kern* opinion suggests that the critical issue in the Court's analysis was not "involuntariness," but rather the absence of opportunity for speculative abuse of inside information. The option transaction that *Kern* held not to be a "sale" was entirely voluntary. Three of the five pre-*Kern* unorthodox transaction cases cited with approval in footnote 26 of *Kern* involved wholly voluntary transactions; [29] the other two were voluntary in form but economically coerced.[30] Footnote 24 of *Kern County*

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[29] 411 U.S. at 594 n.26 (citing *Roberts v. Eaton*, 212 F.2d 82 (2d Cir.) (exchange in recapitalization initiated and controlled by insider), *cert. denied*, 348 U.S. 827 (1954); *Blau v. Max Factor & Co.*, 342 F.2d 304 (9th Cir.) (voluntary exchange), *cert. denied*, 382 U.S. 892 (1965); and *Blau v. Lamb*, 363 F.2d 507 (2d Cir. 1966) (voluntary conversion), *cert. denied*, 385 U.S. 1002 (1967)).

[30] *Ferraiolo v. Newman*, 259 F.2d 342 (6th Cir. 1958) (economically coerced conversion), *cert. denied*, 359 U.S. 927 (1959); *Petteys v.*

includes other transaction forms that are by definition purely voluntary in form (conversions and dealings in rights and warrants). 411 U.S. at 593 n.24. Nowhere did *Kern* say that "involuntariness" is essential to unorthodoxy. In contrast to *Kern's* single use of the word "involuntary," 411 U.S. at 600, Appendix E hereto presents eight excerpts from the *Kern County* majority opinion that refer to the impossibility of speculative abuse of inside information.[31] App. 66a-67a.

The fundamental thrust of the *Kern* analysis, based on the opinion as a whole, is directed at the impossibility of speculative abuse of inside information and is best summarized in the following:

> In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire *whether the transaction may serve as a vehicle for the evil which Congress sought to prevent — the realization of short-swing profits based upon access to inside information.* . . .

411 U.S. at 594 (emphasis added).[32] Thus, the absence of opportunity for speculative abuse by a defendant in a transaction might be demonstrated not only by "involuntariness," but alternatively by the defendant's lack of access to inside information and/or by other characteristics of the transaction (such as the fact that a reorganization or other corporate transaction was equally available to all stockholders, was not initiated or con-

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Butler, 367 F.2d 528 (8th Cir. 1966) (same), *cert. denied*, 385 U.S. 1006 (1967).

[31] The phrase "inside information" appears 20 times in the majority opinion in *Kern*. The word "automatic" never appears.

[32] In another § 16(b) case three years later, the Court described its holding in *Kern* with no mention of involuntariness: "[In *Kern County*] we held that an '*unorthodox transaction*' in securities that did not present the *possibility of speculative abuse* of inside information was not a 'sale' within the meaning of § 16(b)." *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S 232, 237 (1976) (emphasis added).

trolled by the defendant, was accompanied by full disclosure of information by the corporation to its stockholders and/or resulted in no change in the stockholders' relative percentage ownership interests).[33]

Other Circuits have reached conflicting conclusions about whether "involuntariness" is essential under *Kern*. *Compare Texas Int'l Airlines v. National Airlines, Inc.*, 714 F.2d 533, 540 (5th Cir. 1983) (holding a voluntary transaction to be a "sale" under § 16(b) even though the 10% stockholder defendant had no access to inside information and thus could not have engaged in speculative abuse), *cert. denied*, 465 U.S. 1052 (1984),[34] *and Super Stores, Inc. v. Reiner*, 737 F.2d 962 (11th Cir. 1984) (holding a voluntary disposition in a tender offer to be a § 16(b) "sale" even though the tender offer was available to all stockholders and was not controlled by the insider), *with Gold v. Sloan*, 486 F.2d 340, 346 (4th Cir. 1973) (holding a disposition in a merger not to be a "sale" under *Kern County* as to defendant Scurlock, who had no access to inside information, even though he cast the deciding vote to approve the merger), *cert. denied*, 419 U.S. 873

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[33] Such factors (sometimes singly, sometimes in combination) are common threads through the cases that have applied the unorthodox transaction approach, both before and after *Kern*. *See, e.g.*, the cases cited in notes 25 and 28, *supra*.

[34] *Texas International*, however, should not be read to stand for the overly general proposition ascribed to it by the Ninth Circuit, viz., that a disposition "in the face of defeat in a takeover contest . . . is not an 'unorthodox transaction' under *Kern County*." App. 30a. The defendant in *Texas International* was indeed a defeated tender offeror. But the transaction at issue there was not a disposition in a tender offer (coercive or otherwise); it was a garden-variety cash-for-stock transaction available only to the 10% stockholder who sold. The defendant's argument there, which the Fifth Circuit rejected, was that such a transaction should not be a § 16(b) "sale" for the sole reason that the *defendant* was a defeated tender offeror who had no access to inside information. In contrast, Mesa's argument here turns on the nature of the *transaction*, as well as the status of the defendant.

(1974),[35] *and Colan v. Continental Telecom, Inc.*, 616 F. Supp. 1521 (S.D.N.Y. 1985) (holding voluntary grant of option by defeated corporate suitor with no access to inside information not to be a § 16(b) sale), *aff'd without opinion*, 788 F.2d 2 (2d Cir. 1986).[36]

B. Whether "Involuntariness" Is Considered a Necessary Element or Merely a Sufficient Element, the Ninth Circuit's Analysis Thereof Conflicts with the Analysis in *Kern County* and with Decisions of the Second, Sixth and Eighth Circuits

"Involuntariness" (i.e., the absence of realistic alternatives to the transaction at issue) has been a characteristic of many transactions held to be outside the scope of § 16(b), both before and after *Kern County*. Whether it is deemed a necessary element under the unorthodox transaction analysis or, instead, simply one of several potential indicia that a transaction provided

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[35] In the same case, the Fourth Circuit held that the disposition in the merger by defendant Sloan *was* a § 16(b) "sale" because, unlike Scurlock, he had access to inside information. 486 F.2d at 352-53.

[36] For a discussion of the difficulty courts have had with this question, see *Portnoy v. Seligman & Latz, Inc.*, 516 F. Supp. 1188, 1194-95 (S.D.N.Y. 1981):

> [T]he Court [in *Kern County*] suggested several factors to consider . . . [in the analysis]: access to inside information, the voluntariness of the transaction, and the possibility of speculative abuse . . . .
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> . . . .
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> . . . [B]ecause of the variety of statements in *Kern County*, lower courts cannot be certain how to evaluate the factors mentioned in relation to one another. "The Court did not specify which findings . . . are necessary, and which sufficient, to yield the conclusion that a given transaction lies outside the purview of section 16(b)."

(quoting Note, *Exceptions to Liability Under Section 16(b): A Systematic Approach*, 87 Yale L.J. 1430 (1978)).

no opportunity for speculative abuse, its analytical significance is that it demonstrates that a transaction provided no opportunity for speculative abuse of any inside information the defendant might have had. Here, however, the Ninth Circuit (relying in part on a decision of the Seventh Circuit) applied a three-part analysis of the term that conflicts with the concept of involuntariness used in *Kern* itself, with three decisions of the Second Circuit and with decisions of the Sixth and Eighth Circuits.

First, the Ninth Circuit concluded that Mesa's disposition was "voluntary" because Mesa "voluntarily" negotiated with Unocal seeking participation in the Exchange Offer. App. 25a, 34a. But in *Kern,* Occidental voluntarily negotiated its option agreement — and did so to *improve* its position vis-a-vis other Old Kern stockholders, not, as Mesa did here, to eliminate discrimination against it. *See* Part II, *supra.* This Court said Occidental's motivation "d[id] not smack of insider trading," 411 U.S. at 601, and held that neither the grant of the option nor the disposition in the merger was a "sale." *Accord Colan v. Continental Telecom, Inc.,* 616 F. Supp 1521, 1528 (S.D.N.Y. 1985) (holding option agreement negotiated by defeated corporate suitor with no access to inside information not to be a § 16(b) "sale"), *aff'd without opinion,* 788 F.2d 2 (2d Cir. 1986).

Second, the Ninth Circuit concluded that Mesa's disposition was "voluntary" because it had the alternative "choice" of holding its Unocal stock and making another tender offer for additional shares. App. 24a-27a. The Second Circuit, however, has twice held that such a "choice" is not relevant under § 16(b). In *Abrams,* the Second Circuit decision affirmed in *Kern,* Judge Friendly specifically rejected the relevance of such a choice, which was available to Occidental:

> We fail to see the possibility of speculative abuse in a situation where such an offeror simply declines to make a still higher offer or to attempt to block a transaction which it regards as advantageous to all the shareholders *including itself.*

Abrams v. Occidental Petroleum Corp., 450 F. 2d 157, 163 (2d Cir. 1971) (emphasis added), *aff'd sub nom. Kern County*. The Second Circuit reached the same conclusion in *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1055 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000 (1975):

> We hold that whether the tender offeror quits fighting when the defensive merger is announced or continues to fight in the hope of winning, his exchange of stock on the merger after he has been defeated is not *ipso facto* a "sale" for § 16(b) purposes.

There, the Second Circuit emphasized the tender offeror's "inability . . . to affect the course of the target company" in holding the transaction not to be a "sale." 510 F.2d at 1055.

Third, the Ninth Circuit concluded that Mesa's disposition was "voluntary" because it had the "alternative" of simply holding its Unocal shares (notwithstanding the consequent reduction in share value of 40% for any stockholder who did so, or $450 million in Mesa's case), and thus the court rejected Mesa's argument that a transaction voluntary in form is "involuntary" in substance if it is economically coerced. App. 28a-29a. In this respect, the Ninth Circuit's holding conflicts with decisions of the Sixth and Eighth Circuits holding that economically coerced transactions are "involuntary" for purposes of the unorthodox transaction analysis. *Ferraiolo v. Newman*, 259 F.2d 342 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959); *Petteys v. Butler*, 367 F.2d 528 (8th Cir. 1966), *cert. denied*, 385 U.S. 1006 (1967).[37] Both of

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[37] In *Ferraiolo*, convertible preferred stock was "called" by the corporation for redemption at $27 per share in cash. Each preferred share was convertible by the holder into a certain number of common shares, which at the time of the call had an aggregate market value that had risen to $36 per preferred share. The insider chose to convert his preferred into the more valuable common, rather than let it be liquidated into cash by operation of contract on the redemption date. According to the court, the insider's conversion — even though voluntary in form — "was in a very real sense involuntary" since his (or any holder's) failure to convert would have resulted in a loss of

these decisions were cited with approval in *Kern* on the very subject of "alternatives," 411 U.S. at 600, as well as for being seminal cases in the development of the unorthodox transaction doctrine. *Id.* at 594 n.26.[38] *See also Provident Sec. Co. v. Foremost-McKesson, Inc.*, 506 F.2d 601, 605 (9th Cir. 1974) (suggesting that inability to avoid §16(b) liability "without serious detriment" would constitute involuntariness under *Kern* analysis), *aff'd on other grounds*, 423 U.S. 232 (1976).

On the other hand, the Ninth Circuit found support for its conclusion regarding economic coercion in *Oliff v. Exchange International Corp.*, 669 F.2d 1162 (7th Cir. 1980), *cert. denied*, 450 U.S. 915 (1981). There the Seventh Circuit held that a reacquisition of shares was a § 16(b) "purchase" even though it

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about 25% of the value of the investment. Thus the Sixth Circuit held the transaction not to be within the scope of § 16(b). 259 F.2d at 346. *Petteys* involved substantially identical facts (insiders were forced to convert "rather than suffer a needless and substantial economic loss," again about 25% of the value of the investment), and the Eighth Circuit held to the same effect. 367 F.2d at 537. Here, every Unocal stockholder confronted an automatic, immediate 40% decrease in the value of his shares if he failed to participate in the Exchange Offer.

[38] Unocal argued to the Ninth Circuit that the promulgation of Rule 16b-9, 17 C.F.R. § 240.16b-9, under § 16(b) relegated *Ferraiolo* and *Petteys* to mere "historical significance," since by that rule the Securities and Exchange Commission exempted certain conversion transactions from the application of § 16(b). Yet these two cases were among the five cases cited by the Court in *Kern* as principal examples of the unorthodox transaction doctrine. 411 U.S. at 594 n.26. Rule 16b-9 was promulgated in 1966, seven years before *Kern*, and this Court was aware of the rule when it decided *Kern*. *See* 411 U.S. at 612 (Douglas, J., dissenting). The promulgation of Rule 16b-9 did not override or eliminate the analytical force or precedential value of *Ferraiolo* and *Petteys*; it merely relieved the courts, even before *Kern County*, of the burden of deciding cases in this one area of unorthodox transactions. *See* 411 U.S. at 612 (Douglas, J., dissenting) (acknowledging continued significance of these cases).

was motivated by the defendant's desire to avoid paying a tax of 205% of its earlier sale price.

After ignoring the striking similarity of this case to *Kern*, confining *Kern* to mergers, and concluding that "involuntariness" (as narrowly defined by it) was necessary and had not been shown, the Ninth Circuit concluded its opinion by stating that "we do not review the record to determine whether the Mesa Defendants had the opportunity to engage in the speculative abuse of inside information." App. 34a. Thus the Ninth Circuit never even considered — on the fundamental thrust of the *Kern* test — the fact that the transaction in question was one in which there was no possibility for speculative abuse by the defendant.

Numerous characteristics of the transaction — in addition to the undisputed fact that Mesa, a true outsider, had no *access* to inside information — establish that there would have been no *opportunity* for speculative abuse of inside information by Mesa even if it had received any. Unocal's Exchange Offer was initiated and controlled by Unocal, not Mesa. It was a transaction available to all of Unocal's stockholders, not just Mesa. It was accompanied by full disclosure of information by Unocal to all stockholders. It was economically coercive to all stockholders.

V. The Insider Trading and Corporate Takeover Aspects of This Case Underscore Its Importance

In weighing the importance of the question presented by this petition, it is of particular significance that § 16(b) is one of the two principal federal weapons against insider trading, along with § 10(b)'s Rule 10b-5. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. Because § 16(b) is drawn with greater precision than Rule 10b-5, under which the law is largely judge-made, and also because § 16(b) gives the Securities and Exchange Commission exemptive authority, the courts have not played as great a role under § 16(b) as under Rule 10b-5. Nevertheless, the hundreds

of reported § 16(b) cases attest to the very substantial role that the courts have played in the development of the section.[39]

This Court's decision in *Kern County,* which has now been in the books for almost two decades, may well be the most important of any of these cases in its endorsement of the "unorthodox" transaction doctrine. That endorsement has brought a measure of certainty into counsel's advisory task. But the conflicts described above, unless resolved, severely undermine *Kern County*. The Ninth Circuit's decision turns the clock back to pre-*Kern* days and adds substantial confusion to § 16(b) law.

Stability is particularly important in the law affecting corporate takeovers, where the transactions, which often determine the allocation of huge amounts of capital and other resources, have a tremendous impact on the national economy. And history clearly shows that takeovers are a substantial and frequently recurring phenomenon, not only during the mid- and late 1980s, but also over the long term.[40]

If the Ninth Circuit's decision stands, a statute designed to deter short-swing purchase and sale combinations by classic company insiders will have become a weapon for incumbent management to use as a deterrent against any further purchase of stock by any 10% stockholder disfavored by management (who is

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[39] The application of § 16(b) liability to 10% stockholders has received particular focus. Three of the five cases decided by this Court under § 16(b) have resolved liability questions in favor of a 10% stockholder in a takeover or acquisition context. *Foremost-McKesson, Inc. v. Provident Sec. Co.,* 423 U.S. 232 (1976); *Kern County; Reliance Electric Co. v. Emerson Elec. Co.,* 404 U.S. 418 (1972). The Court's other § 16(b) cases are *Gollust v. Mendell,* 111 S.Ct. 2173 (1991) (interpreting standing requirements), and *Blau v. Lehman,* 368 U.S. 403 (1962) (holding partnership not liable for trades by partner).

[40] *See, e.g.,* S.E.C. Advisory Comm. on Tender Offers, *Report of Recommendations* 11 n. 9 (July 8, 1983) (setting forth number of reported tender offers per year, 1965 through 1982, and citing earlier studies).

thus a de facto outsider despite being a de jure insider). Any such stockholder must fear that if he purchases more shares, a hostile management will be able, at least in the Ninth Circuit, to structure an economically coercive transaction that will create "profits" for all stockholders but then immediately recoup the 10% stockholder's share for the company, leaving him and him alone economically punished. That is not the purpose of § 16(b).

If not reconciled by this Court, the sharp conflicts described herein among the Circuits — especially those between the Ninth Circuit and the Second Circuit — will encourage substantial forum shopping. Forum shopping is particularly likely because of the nationwide service of process and broad choice of venue available under the 1934 Act and because § 16(b) questions lend themselves so readily to declaratory judgment actions by the insider.[41]

The decision of the Court of Appeals collides with *Kern County,* with numerous decisions of the Second Circuit and with decisions of three other Circuits. It confuses the law. It is retrogressive. It embraces — indeed all but revels in — an "automatic" and "mechanical" (App. 21a.) interpretation of § 16(b) that produces "purposeless harshness."[42] It should not be allowed to stand.

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[41] Both *Foremost-McKesson,* 423 U.S. 232, and *Reliance Electric,* 404 U.S. 418, for example, were declaratory judgment actions.

[42] *See Blau v. Max Factor & Co.,* 342 F.2d 304 (9th Cir.), *cert. denied,* 382 U.S. 892 (1965).

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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March 6, 1992

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Appendix A

FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

DAVID COLAN, *Plaintiff,* and UNOCAL CORPORATION, *Plaintiff-Appellant,* v. MESA PETROLEUM CO., et al., *Defendants-Appellees.*	No. 90-55641 D.C. No. CV-86-3564-JGD
DAVID COLAN, *Plaintiff-Appellant,* and UNOCAL CORPORATION, *Plaintiff,* v. MESA PETROLEUM CO., et al., *Defendants-Appellees.*	No. 90-55643 D.C. No. CV-86-3564-JGD ORDER AND AMENDED OPINION

Appeal from the United States District Court
for the Central District of California
John G. Davies, District Judge, Presiding

Argued and Submitted
June 6, 1991—Pasadena, California

Filed August 8, 1991
Amended December 23, 1991

Before: Alfred T. Goodwin, Harry Pregerson and Arthur L. Alarcon, Circuit Judges.

Opinion by Judge Alarcon

SUMMARY

Securities

Reversing a district court judgment, the court of appeals held that the sale or purchase of common stock pursuant to a tender offer is a "sale" under section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78p(b)) rather than an "unorthodox transaction" from which the issuer may not seek recovery of profits.

Appellees Mesa Petroleum Company and others (collectively, the Mesa defendants) acquired subtantial stock in appellant Unocal Corporation. Unocal initiated defensive measures to discourage the possibility of a takeover. Mesa continued acquiring common stock and informed the Securities and Exchange Commission that it might seek to obtain control over Unocal's operations. Mesa made a tender offer to purchase Unocal common stock. Unocal rejected the offer. Unocal then offered to exchange debt securities for outstanding Unocal common stock, expressly excluding Mesa from participating in the exchange offer. Negotiations to settle the dispute were unsuccessful. The Delaware Supreme Court upheld Unocal's right to exclude Mesa from the self-tender offer. Following further negotiations, Mesa entities were allowed to participate in Unocal's offer. Mesa exchanged shares of common stock for negotiable debt securities. A Unocal shareholder filed a derivative action on Unocal's behalf, alleging that the Mesa defendants violated section 16(b) and seeking recovery of Mesa's short-swing profits. Unocal joined the suit as a plaintiff. Mesa responded that the

exchange of stock for negotiable debt was not a sale because it fell within the "unorthodox transaction" defense to section 16(b) liability stated in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973). Prior to trial, Unocal moved for an *in limine* ruling that the "unorthodox transaction" defense was not applicable. The parties agreed that the matter would be heard as a motion and cross motion for summary judgment and that the factual record on this issue was already fully developed. The court found in favor of the Mesa defendants, concluding that, although the transaction was a section 16(b) sale, the *Kern County* "unorthodox transaction" defense applied in this case.

[1] Mesa argued that the district court conducted a bench trial, not a hearing on cross motions for summary judgment, and that this court should therefore apply a clearly erroneous standard. [2] Because the record indicates that the district court decided the applicability of the "unorthodox transaction" defense in response to Mesa's request that the matter be treated as a motion for summary judgment, [3] the lower court's order was subject to de novo review on appeal.

[4] Section 16(b) provides that an issuer may recover profits realized by a beneficial owner from the sale of the issuer's equity securities within a six-month period. [5] A sale occurs when an insider becomes irretrievably entitled to receive a sum certain for his security. [6] In *Kern County*, the Supreme Court held that an exchange of stock was not a section 16(b) sale because of the involuntary nature of the exchange, which was required pursuant to the merger of two corporations. [7] This case is factually distinguishable because the exchange of stock for debt securities was not an involuntary or automatic transaction. [8] The Mesa defendants had a choice of participating in the offer or holding onto their stock. [9] They initiated arms-length negotiations with Unocal, seeking participation in the self-tender offer. [10] The record conclusively shows that the exchange of stock for negotiable debt was voluntary.

[11] The Mesa defendants argued that otherwise volitional transactions are unorthodox if a beneficial owner is coerced economically into exchanging his common stock. [12] An economic coercion test is contrary to the intent of Congress in enacting a bright-line, flat rule requiring disgorgement of profits. [13] The facts in this case do not come within the *Kern County* holding that an involuntary transaction resulting from a merger is unorthodox. [14] The sale or purchase of stock pursuant to a tender offer is not an unorthodox transaction.

[15] The Mesa defendants also argued that the exchange was an unorthodox transaction because it resulted from a recapitalization of Unocal. [16] *Kern County* did not involve recapitalization, and [17] other cases cited by the Mesa defendants do not support this argument.

COUNSEL

Darryl Snider, Brobeck, Phleger & Harrison, Los Angeles, California, for the appellant Unocal; William Lerach, Milberg, Weiss, Bershad, Specthrie & Lerach, San Diego, California, for the plaintiff-appellant David Colan.

James Edward Maloney, Baker & Botts, Houston, Texas, for the defendants-appellees.

ORDER

The opinion filed on August 8, 1991, is amended by deleting the following sentence:

> Once in control of Unocal, the Mesa Defendants would have the option of selling off Unocal's assets and thereby recouping any of their losses in the

value of the stock purchased prior to the self-tender offer.

Slip. op. at 10764.

With the opinion so amended, the panel has voted unanimously to deny the petition for rehearing. Judges Pregerson and Alarcon have voted to reject the suggestion for rehearing en banc, and Judge Goodwin recommends such rejection.

The full court has been advised of the suggestion for rehearing en banc and no judge of the court has requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

The petition for rehearing is denied and the suggestion for rehearing en banc is rejected.

OPINION

ALARCON, Circuit Judge:

In this action for recovery of short-swing profits brought pursuant to section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), Unocal Corporation appeals from the denial of its cross motion for summary judgment, and the order granting a motion for summary judgment in favor of Mesa Petroleum Company, Mesa Southern Company, Mesa Asset Company, CY-41, Inc., and Jack-41, Inc. (Mesa Defendants). We must decide whether an exchange by a beneficial owner of its common stock for non-convertible debt securities, in response to a self-tender offer, is a "sale" within the meaning of section 16(b) of the Securities Exchange Act of 1934. We reverse because we have concluded that an exchange of common stock for a negotiable debt security pursuant to a self-tender offer is a "sale" within section 16(b).

Unocal's contentions on appeal can be summarized as follows:

> One. The district court erroneously weighed the evidence and made credibility determinations on ruling on cross motions for a summary judgment.
>
> Two. The district court erred in concluding that Mesa's exchange of Unocal common stock for negotiable debt securities in response to its self-tender offer was an "unorthodox transaction," and not a "sale" requiring a disgorgement by the Mesa Defendants of any profits that may have been realized as a result of this transaction.

PERTINENT FACTS

In October of 1984, Mesa Partners II was formed and began accumulating stock in Unocal. The general partners in Mesa Partners II were: (1) Mesa Asset Company, a wholly owned subsidiary of Mesa Southern Company, which is a wholly owned subsidiary of Mesa Petroleum Company; (2) Cy-41, Inc., wholly owned by Cyril Wagner, Jr.; and (3) Jack-41, Inc., wholly owned by Jack E. Brown.

Cyril Wagner, Jr., and Jack E. Brown are the sole partners of Wagner & Brown, and Brown & Wagner. Cyril Wagner, Jr., and Jack E. Brown, along with Brown & Wagner, are also the partners of Wagner & Brown II. T. Boone Pickens was the President and Chairman of the Board of Directors of Mesa Petroleum Company, President of Mesa Assets Company, and President of Mesa Southern Company. This joint venture shall be referred to as Mesa Partners II in this opinion.

On February 14, 1985, Mesa Partners II filed a Schedule 13D statement[1] with the Securities and Exchange Commission

[1]Section 13(d) of the Securities Exchange Act of 1934 requires any person who becomes a beneficial owner, directly or indirectly, of more than

(SEC), in which it reported that it had acquired 7.3 percent of Unocal's common stock for investment purposes. By February 22, 1985, Mesa Partners II owned 17 million shares of Unocal's common stock, representing 9.7 percent of the outstanding shares.

Unocal initiated defensive measures in order to discourage a perceived takeover threat by Mesa Partners II. On February 25, 1985, Unocal amended its bylaws concerning the procedures for nominating directors and making shareholder proposals. Unocal also filed an action in the Superior Court of the State of California for the County of Los Angeles against Security Pacific National Bank on March 12, 1985, for breach of fiduciary duty, breach of contract, and deceit and misrepresentation in connection with loans it made to Mesa Partners II. Mesa Partners II used the money obtained from these loans to purchase Unocal common stock. Mesa Petroleum Company and Mesa Asset Company responded by filing an action in the same court against Unocal on March 21, 1985, alleging wrongful interference with their banking relationships.

On March 27, 1985, Mesa Partners II acquired a total of 6.7 million shares of Unocal common stock at $48.10 per share. This transaction increased Mesa Partners II's shares to 23.7 million and its ownership interest to 13.6 percent of Unocal's common stock.

On March 28, 1985, Mesa Partners II amended its Schedule 13D statement. Mesa Partners II reported to the SEC that it "may seek to obtain control of the company or to participate in the formulation, determination or direction of the basic business decisions of the Company." Mesa Partners II also

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five percent of any class of equity security to file a statement of ownership with the Securities and Exchange Commission within ten days after reaching the five percent threshold. 15 U.S.C. § 78m(d)(1) (1988). *See also* 1 T. Hazen, *The Law of Securities Regulation* § 11.10 at 688 (2d ed. 1190).

indicated that it intended to solicit proxies to gain postponement of the annual Unocal shareholders meeting then scheduled for April 29, 1985.

On April 1, 1985, Unocal filed a complaint alleging violations of section 13(d) of the Securities and Exchange Act of 1934 against T. Boone Pickens, Jr., Cyril Wagner, Jr., Jack E. Brown, Mesa Partnership, the Partners and certain affiliates of the Partners in the United States District Court for the Central District of California. Unocal claimed that the named defendants or their agents made false and misleading representations in Mesa Partners II's original Schedule 13D statement by indicating that it acquired Unocal common stock for investment purposes. The defendants filed a counterclaim on April 12, 1985, alleging that Unocal violated proxy solicitation rules.

On April 8, 1985, Mesa Partners II made a tender offer to purchase 64 million shares of Unocal common stock at $54 per share.[2] Unocal's Board of Directors recommended that Unocal's shareholders reject Mesa Partners II's tender offer as inadequate and not in their best interests.

On April 16, 1985, Unocal offered to exchange "a package of its debt securities with an aggregate principal amount of $72 . . . consisting of (i) $20 principal amount of 14% Senior Secured Notes Due 1990, (ii) $32 principal amount of Floating Rate Senior Secured Notes Due 1991 and (iii) $20 principal amount of Senior Secured Extendible Notes Due 1997" for up to 87.2 million shares (approximately one-half) of Unocal's outstanding common stock. This offer was originally conditioned upon Mesa Partners II's "acceptance for payment of 64,000,000 Shares pursuant to the Mesa Offer." Unocal modified its offer on April 23, 1985, to provide for the purchase of "up to 50 million shares of its common stock in

[2]Mesa Eastern, Inc., a wholly owned subsidiary of Mesa Partners II, joined with Mesa Partners II in this tender offer.

exchange for $72 per share in senior secured notes, whether or not Mesa purchased the 64 million shares it was seeking through its tender offer."

Unocal stated in its offer that one of its express purposes was "to make it more difficult for Mesa Bidders to complete the Mesa Offer." Unocal expressly excluded Mesa Partners II from participating in its exchange offer. Unocal's exchange offer provided that

> [t]he Company [Unocal] will not accept for exchange, or issue Securities in exchange for, any Shares tendered by or on behalf of Mesa Petroleum, Mesa Partnership, Mesa Sub or any person controlling, controlled by or under common control with any of the foregoing (collectively, the "Mesa Group"), nor any Shares tendered by or on behalf of any other person that were transferred, directly or indirectly, after the date of this Offer to Purchase to such person by any member of the Mesa Group.

On April 22, 1985, Mesa Partners II challenged its exclusion from Unocal's tender offer in Delaware state court. On April 29, 1985, the Court of Chancery temporarily restrained Unocal from proceeding with its offer unless it included Mesa Partners II.

On May 14, 1985, representatives of Unocal and Mesa Partners II, including T. Boone Pickens, met in an attempt to negotiate a settlement. These discussions broke off without resolution. On May 17, 1985, the Delaware Supreme Court reversed the Court of Chancery and held that Unocal was not prohibited by law from excluding Mesa Partners II from its tender offer.

Following the Delaware Supreme Court's decision, representatives of Mesa Partners II contacted Unocal and sought to

reopen negotiations. After several rounds of negotiations, an agreement was reached on May 20, 1985.

Pursuant to the agreement, the "Mesa Entities" were allowed to participate in Unocal's self-tender offer.[3] Mesa Partners II agreed to terminate its tender offer. In addition, Mesa Partners II agreed that it would not participate in any proxy solicitation and would not acquire any additional Unocal shares for a period of twenty-five years. Mesa Partners II also agreed that, for a period of ten years, it would vote its Unocal stock on all matters in the same way and "in the same proportion as the votes cast by holders of Shares other than the Mesa Entities." In addition, Mesa Partners II agreed to strict controls on its ability to sell its Unocal common stock.

On the same date, Mesa Partners II exchanged approximately 7.8 million shares of Unocal common stock for negotiable debt securities.[4] Each of these securities had a stated maturity date and provided for periodic interest payments. Mesa Asset Company sold these debt securities on July 3, 1985, for approximately $589 million.

PROCEDURAL BACKGROUND

On June 3, 1986, David Colan, a shareholder in Unocal, filed a derivative action on behalf of Unocal, alleging violations of section 16(b) by the Mesa Defendants. The action sought recovery of short-swing profits realized by Mesa. Unocal was originally named as a defendant in this action, but was realigned as a real party plaintiff on August 3, 1989.

On September 25, 1989, the Mesa Defendants filed a

[3]The Mesa Entities included Mesa Petroleum Company, Mesa Asset Company, Mesa Partners II, Mesa Eastern, Inc., Cy-41, Inc., Jack-41, Inc., Cyril Wagner, Jr., Jack E. Brown, T. Boone Pickens, Jr., Wagner & Brown, Brown & Wagner, and Wagner & Brown II.

[4]Mesa Partners II was dissolved on May 20, 1985.

motion for summary judgment, in which they argued that the exchange of their common stock for Unocal's debt securities was not a sale within section 16(b). The Mesa Defendants argued that their exchange of stock for negotiable debt securities was not a sale because it fell within the "unorthodox transaction" defense to section 16(b) liability announced by the Supreme Court in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973). The district court denied the Mesa Defendants' motion for summary judgment on October 23, 1989, concluding that genuine issues of material fact existed.

On December 1, 1989, Unocal filed a motion in limine in which it requested the district court to rule, as a matter of law, that the "unorthodox transaction" defense to a section 16(b) violation was inapplicable. In addition, Unocal sought a protective order precluding the Mesa Defendants from introducing any evidence before the jury concerning the "unorthodox transaction" defense. Unocal asserted that if any facts were in dispute concerning the applicability of the "unorthodox transaction" defense, the district court should conduct an evidentiary hearing to resolve the issue before the selection of the jury.

In their opposition to Unocal's motion in limine, the Mesa Defendants "renew[ed] [their] motion for a summary judgment and urge[d] th[e] court to accept plaintiff's belated admission that this is an issue for the Court where the record is sufficiently developed to permit the Court to determine whether the unorthodox transaction exception applies to these facts."

A hearing on the motion in limine was scheduled for January 4, 1990. On that date, the court informed counsel that it would decide the in limine motion concerning the "unorthodox transaction" defense "if there is agreement, unequivocal agreement among counsel that the facts are sufficiently developed to rule on this matter."

Mr. Michael Diamond, counsel for Mesa Petroleum Company, argued that a motion in limine was not the proper vehicle to decide this question. Instead, Mr. Diamond contended that summary judgment is "the way we think it should be decided." After further colloquy, Mr. Diamond stated: "[W]e now renew our summary judgment motion . . . ."

After a brief recess was granted so that Unocal's counsel could consider Mr. Diamond's suggestion, Mr. William Lerach, one of Unocal's attorneys, informed the court as follows: "We are prepared to have the Court treat this issue as tendered to it, if you will, on cross summary judgment motion . . . ."

After further discussion, the court stated: "[Y]our motion in limine will be considered as a cross motion for summary judgment, and Mesa's previously filed summary judgment motion will be reconsidered by the Court, and the record is to be supplemented by a national best seller." The court granted Unocal's unopposed request to receive, as an exhibit, a book written by Mr. T. Boone Pickens. The court declined to hear oral argument concerning the "unorthodox transaction" defense issue.

On January 22, 1990, the court entered an order which "grants Defendants' Motion for Summary Judgment and denies Plaintiffs' Cross-Motion for Summary Judgment."

On January 26, 1990, a hearing was held to determine whether the case should proceed to trial before a jury on January 30, 1990. Unocal argued that a trial was necessary even if the May 20, 1985, exchange of stock for debt securities was an "unorthodox transaction," because the July 3, 1985, disposition of the debt securities by Mesa was a "sale" within section 16(b). The district court reminded Unocal's counsel that during the January 4, 1990, hearing

> you stipulated and agreed that [the in limine] motion may be considered as a cross motion for summary

judgment, and also the representation was made that all of the facts necessary to decide those issues were in the record, either in the motion that was filed by Mesa as Mesa's second motion for summary judgment or in your motion for in limine and elsewhere.

The court informed the parties that they could file supplemental motions relating to the January 19, 1990, order. Counsel for Unocal then inquired as follows:

MR. LERACH: Your Honor, just so I'm clear. You want this done on the existing factual record.

THE COURT: Well, if there are facts that — you see, again, you pose great problems for me. Because the representation was made, it was an unequivocable representation on January the 4th that all of the facts were in the record upon which I could base whatever findings, whatever inferences I could draw for the purpose of ruling on the cross motions for summary judgment. Those facts were before me.

MR. LERACH: That is still our position.

THE COURT: All right.

MR. LERACH: I'm not changing that. I just want to reaffirm that, that we're working off the existing record.

THE COURT: Yes.

MR. LERACH: Thank you.

MR. SNIDER: Neither side will then supplement the record; is that correct, your Honor?

THE COURT: Well —

> MR. SNIDER: The reason I say it's very important, when the submission was made on January 4th, one of the reasons the submission was made to have it treated that way, as a Motion for Summary Judgment. We recessed and we conferred with one another, your Honor will recall, and we came back because we knew what facts were in the record on the issue of voluntariness. And there was a complete void of facts on that record from our point of view with respect to Mesa's position as to either May 20th or July 3rd.

On February 9, 1990, counsel for Mesa Petroleum Company filed a document entitled "Supplemental Motion for Summary Judgment." Mesa Petroleum Company also submitted a proposed order entitled "Supplemental Summary Judgment and Dismissal of Action With Prejudice."

On April 10, 1990, the district court entered a new judgment and vacated the January 19, 1990, order. The court ruled that "[a]lthough Mesa's tender of its Unocal stock in exchange for debt securities can be considered a 'sale', the Court finds that the *Kern County* unorthodox transaction exception applies to the May 1985 exchange offer to exempt it from Section 16(b) liability." The district court again entered an order that granted the Mesa Defendants' motion for summary judgment and denied Unocal's cross motion for summary judgment.

Unocal has timely appealed from the judgment which finally disposes of this section 16(b) action.

DISCUSSION

I. *Nature of the Proceedings Before the Trial Court*

[1] Unocal contends that the district court violated its right to trial by jury by weighing the evidence submitted by the

parties, drawing inferences from conflicting circumstantial evidence, resolving disputed issues of fact, and determining the credibility of T. Boone Pickens' testimony, in ruling on cross motions for a summary judgment. The Mesa Defendants do not dispute Unocal's argument that the district court failed to consider the evidence in the light most favorable to Unocal in ruling on the motion for a summary judgment. Instead, the Mesa Defendants contend that the district court conducted a bench trial, not a hearing on cross motions for summary judgment. The Mesa Defendants argue that we must review the district court's judgment under the clearly erroneous standard.

The record does not support the Mesa Defendants' contention that the parties "authorized the court to conduct a bench trial." Appellees' Brief at 14. The Mesa Defendants requested that the district court reconsider their motion for a summary judgment rather than act on Unocal's motion in limine. The Mesa Defendants prepared a proposed order granting their motion for a summary judgment and dismissing Unocal's action with prejudice.

The Mesa Defendants' reliance on *Wolfe v. United States*, 798 F.2d 1241 (9th Cir.), *amended on other grounds*, 806 F.2d 1410 (9th Cir. 1986), *cert. denied*, 482 U.S. 927 (1987), is misplaced. In *Wolfe*, we concluded, after reviewing the record, that "the parties intended to submit the case for a bench trial on stipulated facts." *Id.* at 1243-44 n.2. The other cases relied upon by the Mesa Defendants also involve facts showing that the parties intended to waive trial by jury and try their cases on stipulated or agreed facts. *Starsky v. Williams*, 512 F.2d 109, 111 (9th Cir. 1975); *Southwest Forest Indus., Inc. v. Westinghouse Elec. Corp.*, 422 F.2d 1013, 1016-17 (9th Cir.), *cert. denied*, 400 U.S. 902 (1970); *Gillespie v. Norris*, 231 F.2d 881, 883 (9th Cir. 1956).

Unlike the situation in the cases relied upon by the Mesa Defendants, in the instant matter the parties expressly agreed to have the court decide the applicability of the "unorthodox

transaction" defense on cross motions for summary judgment. The court reflected this mutual understanding by stating: "It's now stipulated to be a motion, a cross summary judgment motion."

On the same date that the "unorthodox transaction" defense issue was submitted to the court for decision without oral argument on the cross motions for summary judgment, the record reflects that the court inquired of counsel about the "timing for trial." The court stated that "[t]here is a distinct possibility that I can start this case on January 30th." After some discussion, the trial date was set for January 30, 1985. Mr. Diamond, an attorney for Mesa Petroleum Company, then inquired of the court how counsel should respond "on the question of our desires on the jury/non-jury issue?" The court replied: "Make up your mind and let me know." Another of Mesa Petroleum Company's attorneys, Mr. James Edward Maloney, whose law office is in Texas, then asked the court whether the trial judge conducts the voir dire in the Central District of California. Thereafter, Mr. Maloney's request to be allowed to question the prospective jurors on voir dire was granted.

In light of the state of the record in this matter, which shows that the Mesa Defendants requested that the court determine the applicability of the "unorthodox transaction" defense on summary judgment rather than in a non-reviewable motion in limine proceeding, and sought permission to participate in the voir dire examination of the jurors, if they decided not to waive a trial by jury, we are troubled that they now argue that the record shows that the parties agreed to a bench trial. This type of overzealous advocacy burdens the court with a frivolous argument and does little to guide us in our efforts to reach a just result.

[2] Because the record demonstrates that the district court decided the applicability of the "unorthodox transaction" defense in response to the Mesa Defendants request that the

denial of its motion for a summary judgment be reconsidered, we must reject their contention that we should review the judgment for clear error.

[3] We review an order granting summary judgment *de novo*. *Ashton v. Cory*, 780 F.2d 816, 818 (9th Cir. 1986). Thus, we are required to review all the evidence presented to the district court in the light most favorable to the non-moving party. *Id.* We must also make an independent, non-deferential, determination concerning the question whether the district court correctly applied the law. *Id.* Because our review is independent, any error committed by the district court in weighing the evidence, drawing inferences from disputed facts, and in determining credibility in this matter was harmless.

II. *Applicability of the "Unorthodox Transaction" Defense Under These Facts*

Unocal argues that the district court erred in concluding that the "unorthodox transaction" defense to an action for disgorgement of short-swing profits by a beneficial owner is applicable if the facts in the record in this matter are viewed in the light most favorable to the Mesa Defendants. Unocal asks this court to direct the entry of a summary judgment in its favor on the ground that the exchange of the Mesa Defendants' common stock for negotiable debt securities was a "sale" within section 16(b). Unocal asserts that the "unorthodox transaction" defense to an action brought pursuant to section 16(b) is not applicable to a self-tender offer in which a beneficial owner exchanges his common stock for negotiable debt securities issued as a result of a recapitalization of the issuer.

[4] Section 16(b) of the Securities Exchange Act of 1934 provides that an issuer may recover any profits realized by a beneficial owner from the sale of the issuer's equity securities

within a six-month period.[5] A beneficial owner is a shareholder who owns, directly or indirectly, more than ten percent of any class of equity security. 15 U.S.C. § 78p(a) (1988).

One goal of the Securities and Exchange Act of 1934 is to " 'insure the maintenance of fair and honest markets.' " *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 591 (1973) (quoting 15 U.S.C. § 78b). In adopting section 16(b), Congress intended "to curb manipulative and unethical practices resulting from misuse of corporate information for personal enrichment or unfair profit of the insider, thereby assuring the strict observance of the insider's fiduciary duties to outside shareholders and the corporation by removing the profit from short-swing dealing in corporate securities." *Oliff v. Exchange Int'l Corp.*, 669 F.2d 1162, 1165 (7th Cir. 1980), *cert. denied*, 450 U.S. 915 (1981).

In order to achieve these goals, Congress adopted "a flat rule taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great." *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422 (1972). " 'The objective standard of Section 16(b) imposes strict liability upon substantially all transactions occurring within the statutory time period, regardless of the intent of the insider or the existence of actual speculation.' " *Id.* (quoting *Bershad v. McDonough*, 428 F.2d 693, 696 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971)).

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[5]Section 16(b) provides in pertinent part:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction . . . .

15 U.S.C. § 78p(b) (1988).

Section 16(b) has been referred to as a "crude rule of thumb." *Kern County Land Co.*, 411 U.S. 582, 592-93 n.23 (1973) (quoting *Hearings on Stock Exchange Practices before the Senate Committee on Banking and Currency*, 73d Cong., 2d Sess., pt. 15, at 6557 (1934)). We have described the application of section 16(b)'s bright-line rule as "mechanical," *Portnoy v. Memorex Corp.*, 667 F.2d 1281, 1282 (9th Cir. 1982), and "automatic," *Whittaker v. Whittaker Corp.*, 639 F.2d 516, 522 (9th Cir.), *cert. denied*, 454 U.S. 1031 (1981). Where a transaction involving an equity security falls within the objective standards established by Congress for section 16(b), liability attaches. *Id.*

[5] The Securities Exchange Act of 1934 broadly defines "sale" as "any contract to sell or otherwise dispose of" any security. 15 U.S.C. § 78c(a)(14) (1988). A "sale" has been deemed to occur "when an insider becomes irrevocably *entitled* to receive a sum certain for his security," *Seinfeld v. Hospital Corp. of Am.*, 685 F. Supp. 1057, 1062 n.5 (N.D. Ill. 1988) (emphasis in original), or when "the insider has incurred an 'irrevocable liability' to dispose of the stock so that his 'rights and obligations' have become fixed," *Lewis v. Bradley*, 599 F. Supp. 327, 330 (S.D.N.Y. 1984).

The district court concluded that "[a]lthough Mesa's tender of its Unocal stock in exchange for debt securities can be considered a 'sale', the Court finds that the *Kern County* unorthodox transaction exception applies to the May 1985 exchange offer to exempt it from Section 16(b) liability."

The Mesa Defendants conceded, at oral argument, that their exchange of Unocal equity stock for debt securities pursuant to Unocal's self-tender offer was a "sale" if section 16(b) is given a literal interpretation.[6] The Mesa Defendants contend

[6]During oral argument, the court questioned whether the exchange transaction would fit within the broad definition of "sale," as that term is used in section 16(b). Counsel for the Mesa Defendants responded: "Yes, your honor, were it not for the [unorthodox transaction] exemption, it would."

that their exchange of stock for non-convertible debt securities on May 20, 1985, falls within the "unorthodox transaction" defense to section 16(b) liability established by the Supreme Court in *Kern County*.

In *Kern County*, the Supreme Court addressed the following fact-specific question: "[I]s it a § 16(b) 'sale' when the target of [a] tender offer defends itself by merging into a third company and the tender offeror then exchanges his stock for the stock of the surviving company and also grants an option to purchase the latter stock that is not exercisable within the statutory six-month period?" 411 U.S. at 584.

In *Kern County*, Occidental Petroleum Corporation announced a tender offer to purchase 500,000 shares of Kern County Land Company (Kern County) common stock. The tender offer was expressly due to expire on June 8, 1967. *Id.* Kern County opposed Occidental's takeover attempt and, on May 19, 1967, announced the Board of Directors' approval of a "defensive" merger with Tenneco, Inc. *Id.* at 585-86. Pursuant to the merger, the Kern County shareholders would receive one share of Tenneco cumulative convertible preference stock for each share of Kern County common stock. *Id.*

The Kern County shareholders approved the merger with Tenneco on July 17, 1967. *Id.* at 588. Occidental issued a statement that it had decided not to oppose the merger, but it refrained from voting its shares in favor of the merger. *Id.* The merger between Kern County and Tenneco became effective on August 30, 1967, within six months from the expiration date of the Occidental tender offer. *Id.* at 589. On this date, all Kern County shareholders became irrevocably entitled to receive one share of Tenneco preference stock in exchange for each share of Kern County stock. *Id.* Occidental realized a $19,506,419.22 profit on the Kern County shares it acquired through its tender offer. *Id.* at 589-90.

The new Kern County Land Company that was formed as a result of the merger, filed an action against Occidental under

section 16(b) to recover the profits from the sale. *Id.* at 590. The district court held that the automatic exchange of shares on August 30, 1967, constituted a "sale" within the meaning of section 16(b). *Id.* The Second Circuit reversed, holding that the automatic exchange of shares pursuant to the merger did not constitute a "sale" for section 16(b) purposes. *Id.* at 590-91. The Supreme Court granted certiorari. *Id.* at 591.

In determining whether the exchange of stock pursuant to the merger between Kern County and Tenneco was a "sale" giving rise to section 16(b) liability, the Supreme Court first recognized that the statute imposed a " 'flat rule.' " *Id.* at 592 (quoting *Reliance Elec. Co.*, 404 U.S. at 422). The Court then noted that

> [a]lthough traditional cash-for-stock transactions that result in a purchase and sale or a sale and purchase within the six-month, statutory period are clearly within the purview of § 16(b), the courts have wrestled with the question of inclusion or exclusion of certain "unorthodox" transactions. . . . In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent — the realization of short-swing profits based upon access to inside information — thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits.

Id. at 593-95 (footnotes omitted).[7]

[7]Courts have referred to *Kern County*'s approach to determining section 16(b) liability in unorthodox transactions as a "pragmatic" approach, *Provident Sec. Co. v. Foremost-McKesson, Inc.*, 506 F.2d 601, 604 (9th Cir. 1974), *aff'd on other grounds*, 423 U.S. 232 (1976), in contrast to the "objective" approach of imposing liability in transactions which are clearly within the ambit of section 16(b).

[6] The Court held that the exchange of Kern County stock for Tenneco stock on August 30, 1967, was not a "sale" within the scope of section 16(b). *Id.* at 596. The Court concluded that "the involuntary nature of Occidental's exchange, when coupled with the absence of the possibility of speculative abuse of inside information, convinces us that § 16(b) should not apply to transactions such as this one." *Id.* at 600. In reaching this conclusion, the Court characterized as "critical" the fact that the exchange was required pursuant to the merger between Kern County and Tenneco. *Id.* at 599. "Once the merger and exchange were approved, Occidental was left with no real choice with respect to the future of its shares of Old Kern." *Id.* at 600.

[7] The exchange of Unocal stock for debt securities pursuant to Unocal's tender offer is factually distinguishable from the transaction in *Kern County*. The exchange of Occidental's stock for equity shares of the new corporation which was formed as the result of the merger in *Kern County* was involuntary and automatic. The May 20, 1985, exchange of stock for debt securities by the Mesa Defendants was not an involuntary or automatic transaction. Unocal did not merge into a new corporation so as to compel its shareholders to exchange their stock.

The Mesa Defendants not only were not compelled to exchange their stock for Unocal's debt securities, but Unocal expressly excluded them from its self-tender offer. The Mesa Defendants filed a suit in Delaware seeking an injunction to force Unocal to permit the Mesa Defendants to participate in Unocal's tender offer.

[8] The Mesa Defendants had the choice of participating in the tender offer or holding onto their stock. The record shows that it was anticipated that Unocal's stock would sell at $30 a share as a result of the exchange set forth in the tender offer. One of the choices available to the Mesa Defendants was to

buy up Unocal's stock at the reduced price of $30 a share and acquire control of the corporation.

[9] The evidence is undisputed that the Mesa Defendants initiated negotiations with Unocal, seeking participation in the self-tender offer. In the book, *Boone*, which is part of the record in this matter, T. Boone Pickens states that one of his attorneys told Unocal representatives that "[Mesa] would have to be included in their tender offer or take action to protect [them]selves." T. Pickens, *Boone* 282 (1987). The parties dealt at arms length in the negotiations that followed. Unocal was concerned that if the Mesa Defendants were excluded, they might buy up the devalued shares at a bargain price and seize control of the corporation. Mr. Pickens describes the stakes for each side in the negotiations following the Delaware Supreme Court's decision in favor of Unocal as follows:

> This meant that Hartley didn't have to offer Mesa anything. He could buy back the stock from all the shareholders but us, decreasing the value of the remaining Unocal stock. If Unocal bought back 70 million shares at $72, that left 100 million shares that would be worth a lot less, including all of the Mesa Partners holdings, which would drop to around $30 a share after the buyback. Our stock would then be worth less than $700 million — a loss of about $300 million.
>
> This new ruling was unprecedented, but there was no use crying about it. We had a choice: we could make a deal with Unocal, or after they concluded their tender offer we could make a 100 percent all-cash offer for the company. We got a call from Drexel asking us not to fold. They had raised $3 billion and were ready to raise the additional funds for us to make a 100 percent offer. It was an unqualified endorsement of Mesa, and it naturally gave us a lift.

> It would be a great campaign, no doubt about it, but the risks were getting very high. It wasn't time to get emotionally involved. It hadn't been a year since we had gotten out of a $300 million jam, so I wasn't ready to step up to the table and put everything on 7 and call for the dice. It might work — but it might not. If Mesa went all out for Unocal, Hartley would probably pull the same exclusionary self-tender the second time, and then we would be back in the Delaware court. We had been nailed once, and that was one time too many.
>
> We could force Fred to take on even more debt, and he was gagging now. But there was no guarantee we would win.

Id. at 281.

In a subsequent passage, Mr. Pickens stated:

> Stillwell got a call from Los Angeles on Sunday afternoon. Hartley was ready to talk. He would agree to Mesa's demands but had one of his own. He wanted us to pay Unocal's expenses — a silly request but a big point to Hartley. If he could get us to pay his expenses, he would never let us forget it. We still had our tax treatment "ace" up our sleeve. If we were included in Unocal's offer and held the remainder of our stock for a year, we would make around $80 million after taxes. The trick was to keep Unocal from figuring it out.

Id. at 282.

Mr. Pickens describes the effect of the negotiations on Unocal and the Mesa Defendants as follows:

> Our team signed the deal and flew home on Monday night. The Mesa-Unocal deal was history. Hartley

> was soon crowing that he had defeated Pickens and tied up Mesa for a year because we had to hold their stock. He claimed we had lost $100 million. It was just the opposite. We were going to make money, but we couldn't announce it until our auditors, Arthur Anderson, had signed off. We also wanted to receive the proceeds from Unocal before announcing any profit. That meant waiting sixty days or so, but we just didn't trust them.
>
> I could barely keep quiet as I read Hartley's claims of having 'beaten' Mesa. Then, two months later, the Unocal bonds in hand, we enjoyed the last laugh — $83 million profit after taxes, twice what we had made in the Phillips deal.
>
> When you have to explain a victory, it becomes something less. Gradually the financial community, the press, and the academicians came to understand what we had done.

Id. at 284.

[10] Unlike the plight of the hapless beneficial owner in *Kern County*, the record conclusively shows that the Mesa Defendants voluntarily exchanged their common stock for negotiable debt securities. The exchange in the matter *sub judice* was not the inexorable consequence of corporate machinations that forced the stockholders to exchange their shares as the result of the dissolution of the corporation. Here, the beneficial owners controlled their own destiny and skillfully negotiated a result that Mr. Pickens characterized as a victory for his side.

Courts following *Kern County* have recognized that involuntariness is an important factor in determining whether or not a transaction constitutes a "sale" or "purchase" within section 16(b). In *Provident Sec. Co. v. Foremost-McKesson, Inc.*,

506 F.2d 601 (9th Cir. 1974), *aff'd on other grounds*, 423 U.S. 232 (1976), we stated that "[a]bsent a showing of involuntariness, we would not be justified in applying the *Kern County* rule." *Id.* at 606. *See also Texas Int'l Airlines v. National Airlines, Inc.*, 714 F.2d 533, 540 (5th Cir. 1983) ("[T]he volitional character of the exchange is sufficient reason to trigger applicability of the language of section 16(b)."), *cert. denied*, 465 U.S. 1052 (1984); *Gund v. First Florida Banks, Inc.*, 726 F.2d 682, 686 (11th Cir. 1984) ("The vast majority of cases in which the pragmatic approach has been followed involve involuntary transactions which are triggered by a corporate reorganization . . . .").

[11] The Mesa Defendants argue that "otherwise volitional transactions" are unorthodox under section 16(b) if a beneficial owner is coerced economically into exchanging his common stock or suffer a financial loss. In *Oliff v. Exchange Int'l Corp.*, 669 F.2d 1162 (7th Cir. 1980), *cert. denied*, 450 U.S. 915 (1981), the Seventh Circuit found that although a 205% tax payment was not a "reasonable alternative" to the repurchase of shares which gave rise to section 16(b) liability, the acquisition of the stock was not "so involuntary as to take it out of the definition of 'purchase' for 16(b) purposes." *Id.* at 1168. In *Tyco Laboratories, Inc. v. Cutler-Hammer, Inc.*, 490 F. Supp. 1 (S.D.N.Y. 1980), the court rejected the argument that section 16(b) should not apply because the sale of stock was coerced. The court stated that

> [a]lthough plaintiffs had the option to maintain their ownership interest in C-H stock, they chose not to exercise that option. The fact that plaintiffs may have found it to be more financially advantageous to sell their C-H stock on June 12, 1978 than at a later time cannot be a basis for characterizing the sale transaction as involuntary.

Id. at 8.

[12] An economic coercion test would allow corporate insiders to avoid section 16(b) liability by presenting evidence of a variety of unfortunate circumstances that forced them to sell their common stock. The objective standards of section 16(b) were adopted to avoid the necessity for an inquiry into an insider's subjective "intent." *Reliance Elec. Co.*, 404 U.S. at 422 (quoting *Bershad*, 428 F.2d at 696). We reject the "economic coercion" test as contrary to the intent of Congress in enacting the bright-line, flat rule set forth in section 16(b) requiring disgorgement of profits.

[13] We conclude that the facts in this matter do not come within the holding of *Kern County* that an involuntary transaction that results from a merger is "unorthodox."

The cases that have applied the *Kern County* "unorthodox transaction" defense to a short-swing sale by a beneficial owner have characterized it as a narrow exception to section 16(b). *See, e.g., Texas Int'l Airlines*, 714 F.2d at 539 ("In *Kern County* the Supreme Court approved an extremely narrow exception to the objective standard of section 16(b)."). The Supreme Court did not indicate that the courts should conduct an ad hoc, case-by-case analysis of all securities transactions involving a sale by a beneficial owner. The Court in *Kern County* simply held that an automatic exchange of stock in one company for stock in another company pursuant to a merger between the two companies, over which the shareholder had no control, is not a form of transaction covered by section 16(b). 411 U.S. at 600.

The majority of the transactions which have been considered "unorthodox" within the narrow exception announced in *Kern County* involve exchanges of stock pursuant to a merger. *See, e.g., Heublein, Inc. v. General Cinema Corp.*, 722 F.2d 29, 31 (2d Cir. 1983) (section 16(b) is not intended to apply to an involuntary exchange of shares resulting from a merger), *cert. denied*, 465 U.S. 1066 (1984); *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1053 (2d Cir. 1974) (*Kern*

County applies to a defensive merger where the beneficial owner tries to defeat it), *cert. denied*, 421 U.S. 1000 (1975); *Gold v. Sloan*, 486 F.2d 340, 344 (4th Cir. 1973) (exchange of shares pursuant to a merger may not constitute a purchase under section 16(b)), *cert. denied*, 419 U.S. 873 (1974); *National Westminster Bancorp v. Leone*, 702 F. Supp. 1132, 1138 (D.N.J. 1988) (merger is an "unorthodox transaction" requiring an examination of the goals of section 16(b)); *Colan v. Prudential-Bache Secs., Inc.*, 577 F. Supp. 1074, 1081 (N.D. Ill. 1983) ("forced exchange of securities pursuant to a merger" is not a sale within section 16(b)).

Those courts that have directly addressed the issue of section 16(b) liability in a tender offer or hostile takeover context have concluded that the disposition of shares pursuant to a tender offer, or in the face of defeat in a takeover contest, is not an "unorthodox transaction" under *Kern County*. In *Super Stores, Inc. v. Reiner*, 737 F.2d 962 (11th Cir. 1984), the Eleventh Circuit held that *Kern County* did not create an exception from the short-swing profit prohibitions of section 16(b) for a transaction in which "a corporate officer and director facing defeat in a tender offer battle voluntarily tendered his stock to his opponents for cash." *Id.* at 965. In *T-Bar, Inc. v. Chatterjee*, 693 F. Supp. 1 (S.D.N.Y. 1988), a defeated tender offeror converted debentures into common stock of the target corporation and tendered those shares into a competing cash tender offer for 70% of the target's stock. *Id.* at 4. The court held that this transaction was not the form of transaction held to be "unorthodox" in *Kern County*. *Id.* at 5. Instead, the court stated that "[u]nlike the defendant in *Kern County*, Beall made a business decision to tender its shares into the Data Switch offer." *Id.*

In a hostile takeover situation, the Fifth Circuit held that *Kern County* did not apply to a transaction in which a defeated tender offeror sold its shares in the target corporation to a company with which the target had entered into a merger agreement. *Texas Int'l Airlines*, 714 F.2d at 540. In *Tyco Lab-*

oratories, the court rejected a claim that the existence of a "control contest type of situation" renders the sale of stock to a third party "unorthodox" within the meaning of *Kern County*. 490 F. Supp. at 6. In *Lane Bryant, Inc. v. Hatleigh Corp.*, 517 F. Supp. 1196 (S.D.N.Y. 1981), a ten-percent shareholder facing opposition to its intended proxy contest sold all of its stock to the corporation for a premium. *Id.* at 1197-98. The court found that *Kern County*'s pragmatic test for "unorthodox transactions" was inapplicable, ruling instead that

> the objective test [of § 16(b)] should clearly apply to the instant case since the defendant here both purchased and sold plaintiff's stock for cash and, while there was a contest for control, this case differs from Kern County and American Standard, where the target merged with a third corporation, causing the defendant tender offeror to become a minority shareholder in the third corporation, in that here there was no defensive merger, but rather the defendant simply decided it was unprofitable to pursue the proxy contest.

Id. at 1200.

Mesa cites only one case, *Pier 1 Imports of Georgia, Inc. v. Wilson*, 529 F. Supp. 239 (N.D. Tex. 1981), in which a tender offer was determined to be an "unorthodox transaction" for section 16(b) purposes. In *Pier 1 Imports*, the court stated that "a tender offer has been found to fall within the unorthodox transaction rubric rather than a 'garden variety' Section 16(b) claim." *Id.* at 242-43. The district court in *Pier 1 Imports* cited *Makofsky v. Ultra Dynamics Corp.*, 383 F. Supp. 631, 637 (S.D.N.Y. 1974), and *Securities and Exchange Commission v. Texas Int'l Co.*, 498 F. Supp. 1231, 1239 (N.D. Ill. 1980), for this proposition. *Pier 1 Imports*, 529 F. Supp. at 242-43. *Makofsky* and *Texas Int'l* do not support the district court's holding in *Pier 1 Imports*.

Makofsky does not involve a tender offer. It involves a section 16(b) action seeking recovery of profits realized by an insider through the purchases and sales of option shares. *Makofsky*, 383 F. Supp. at 636. The court held that section 16(b) was applicable. *Id.* at 643. The language in *Makofsky*, upon which *Pier 1 Imports* relies, stating that "tender offers . . . are not suited to mechanical application of the statute," is dictum and is based on pre-*Kern County* cases, none of which involve an exchange of stock pursuant to a tender offer. *Id.* at 637.

In *Texas Int'l*, the district court had before it a claim filed by the SEC pursuant to section 14(b) of the Williams Act. The applicability of section 16(b) was not an issue in *Texas Int'l*. Section 16(b) was referred to in a parenthetical explanation of *Kern County*'s application of the "unorthodox transaction" in deciding whether to apply section 16(b). 498 F. Supp. at 1239.

[14] We agree with the Eleventh Circuit in *Super Stores*, and the district court in *T-Bar Inc.*, that the sale or purchase of stock pursuant to a tender offer is not an "unorthodox transaction."

[15] The Mesa Defendants assert that the exchange of their common stock for debt securities was an "unorthodox transaction" because it resulted from a recapitalization of Unocal. The Mesa Defendants rely primarily on the Supreme Court's comment in footnote 24 in *Kern County* to support this proposition. 411 U.S. at 593 n.24. In footnote 24, the Court observed that "[t]he term [unorthodox transaction] . . . has been applied to stock conversions, exchanges pursuant to mergers and other corporate reorganizations, stock reclassifications, and dealings in options, rights, and warrants." *Id.* The Mesa Defendants reason that since a recapitalization is a form of corporate reorganization, it must constitute an "unorthodox transaction."

[16] The comment in footnote 24 in *Kern County* was not necessary to the opinion in *Kern County*. *Kern County* did not

involve recapitalization. The Court, without expressing its approval, enumerated the types of business transactions that others have labeled as "unorthodox." The Court did not cite any authority to support its observation in footnote 24. Thus, we cannot determine whether the Court was referring to decisions construing section 16(b).

The Mesa Defendants rely on two district court decisions published solely in the Federal Securities Law Reporter to support their view that a corporate recapitalization is an "unorthodox transaction." Neither supports their position. In *Rothenberg v. United Brands Co.*, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd without opinion*, 573 F.2d 1295 (2d Cir. 1977), the district court concluded that no violation of section 16(b) occurred because the record showed that "[w]hen United exchanged or converted these common shares into Class A, the total amount of its investment in Foster did not change." *Id.* at 91,694. The court concluded that this exchange did not involve a new investment. *Id.* The court held that "[i]t would appear that to be a sale under § 16(b), there must be some change in either the character of the investment or the nature of the market risk assumed." *Id.*

[17] In *Hayes v. Sampson*, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,693 (S.D.N.Y. Nov. 18, 1980), the district court, relying on *Rothenberg*, held that no sale within section 16(b) occurred where the directors of a corporation exchanged old debentures for new debentures because "neither the amount invested nor the percentage of ownership of this class of security changed within the six month period relevant under Section 16(b)." *Id.* at 98,644. If anything, *Rothenberg* and *Hayes* stand for the proposition that a recapitalization which results in a change in the nature of a beneficial owner's investment and market risk is a sale within section 16(b).

In the instant matter, the nature of the Mesa Defendants' investment was changed. They exchanged common stock for

negotiable debt securities with a higher market value. The Mesa Defendants' market risk also changed from that of an equity owner of shares in a corporation, subject to market fluctuations, to a holder of negotiable debt securities which obligated Unocal to pay a fixed sum at a certain maturity date together with periodic interest payments.

CONCLUSION

The evidence is undisputed that the Mesa Defendants made a voluntary business decision to persuade Unocal to permit them to participate in the corporation's self-tender offer. As a result, the Mesa Defendants exchanged common stock, whose value was subject to the risks of a free market, for negotiable debt securities of a higher current value with fixed payments and interest rates. The record also shows that the Mesa Defendants shrewdly calculated their options, which included a complete buy out of all of Unocal's stock or acceptance of the self-tender offer because of undisclosed tax advantages. We conclude that the exchange of the Mesa Defendants stock for Unocal's negotiable debt securities was a sale within section 16(b). Because of our determination that this exchange was not an "unorthodox transaction," we do not review the record to determine whether the Mesa Defendants had the opportunity to engage in the speculative abuse of inside information.

The order granting summary judgment in favor of the Mesa Defendants is **REVERSED**. The order denying Unocal's cross motion for a summary judgment is **REVERSED** with directions to enter an order granting Unocal's motion for a summary judgment.

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Appendix B

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

DAVID COLAN AND UNOCAL CORPORATION, *Plaintiffs,* v. MESA PETROLEUM CO., *et. al.* *Defendants.*	CASE NO. CV 86-3564 JGD ORDER RE: CROSS MOTIONS FOR SUMMARY JUDGMENT

This securities case arising under Section 16(b) of the Securities and Exchange Act of 1934 is presently before the Court on the parties' Cross-Motions for Summary Judgment. The question presented to the Court is whether on the facts of this case a sale exists for the purpose of Section 16(b) liability.

STATEMENT OF THE CASE

Unocal is a corporation organized and existing under the laws of the state of Delaware with its principal place of business in Los Angeles, California. Unocal engages in exploration and production activities in the major oil and gas areas of the United States and 14 foreign countries. Mesa Petroleum Co. was a corporation organized under the laws of the state of Delaware with its principal place of business in Amarillo, Texas. Until December 27, 1985, Mesa Petroleum was engaged in the exploration for and production of natural gas. Mesa Partners II was a Texas general partnership which was dissolved on May 20, 1985. The remaining defendants are either wholly owned subsidiaries of Mesa Petroleum or general partners in Mesa Partners II.[1] Prior

[1] Defendants, hereinafter "Mesa", are Mesa Petroleum Co., Mesa Southern Co., Mesa Asset Co., Cy-41, Inc. and Jack-41, Inc. Mesa

to this litigation, Mesa had invested in, owned, and traded various securities.

In October 1984, Mesa began to invest in Unocal stock. From October into early February 1985, Mesa purchased Unocal shares through the Fayez Sarofim Trust Company. In February 1985, Mesa began to purchase Unocal stock through Jefferies & Co., a Los Angeles stock brokerage firm. Mesa first publicly announced its Unocal holdings on February 14, 1985; on that date, Mesa filed a Schedule 13D with the Securities and Exchange Commission ("SEC") indicating that Mesa had acquired 7.3 percent of Unocal's outstanding stock as an investment.[2] As of February 22, 1985, Mesa owned 17 million shares which equalled 9.7 percent of the outstanding shares of Unocal stock.

By March 27, 1985, Mesa had purchased 6.7 million additional shares of Unocal stock at a price of $48.10 per share.[3] Mesa now owned 23.7 million Unocal shares and was a more than 10% owner of Unocal stock. On March 28, 1985, Mesa announced its intention to wage a proxy fight to postpone the annual Unocal shareholders' meeting. At the same time, Mesa filed a third amendment to its Schedule 13D which stated that Mesa might seek control of Unocal. On April 1, 1985, Unocal sued Mesa in the United States District Court for the Central District of

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Partners II originally named as a defendant in this action was dissolved on May 20, 1985.

[2] Any person who either directly or indirectly becomes a beneficial owner of more than five percent of stock shall, within ten days of such acquisition, send to the issuer of the stock, the exchanges upon which the security is traded, and the Commission certain statutorily required information. 15 U.S.C. 78m(d).

[3] Although the parties continue to dispute the manner in which this stock was obtained and whether the stock price was actually $48.10 or $48 with a 10 cents per share commission to Jefferies & Co. as broker, the issue of a Section 16(b) purchase is not relevant to these motions. The unorthodox transaction exception concerns the applicability of a "sale" for the purpose of Section 16(b) liability.

California challenging the accuracy of statements in Mesa's original Schedule 13D. Mesa counterclaimed urging violations of the proxy solicitation rules.

On April 8, 1985, Mesa commenced a tender offer to purchase 64 million shares of Unocal stock at $54 per share. The market price of Unocal stock at the time was $49 per share. Unocal's Board of Directors publicly rejected Mesa's tender offer on April 14, 1985. On April 16, Unocal responded to Mesa's tender offer by proposing its own self tender offer which Unocal made contingent upon Mesa's success. In essence, Unocal offered to exchange debt securities in the principal amount of $72 per share for up to 87.2 million shares, approximately one-half of the 173.9 million shares of Unocal stock outstanding. Unocal modified this offer on April 23 to reflect its willingness to purchase up to 50 million shares of its common stock regardless of whether Mesa actually purchased the 64 million shares it was seeking. It was generally anticipated that any shares not acquired by Unocal in the exchange would have a market value thereafter equalling $30 per share.[4]

The novel aspect of Unocal's exchange offer was that it specifically excluded Mesa from tendering its Unocal stock. Assuming *arguendo* that Mesa made no other attempt to alter its Unocal holdings, such exclusion, upon completion of the exchange, would result in a decrease in the value of Mesa's Unocal holdings from $1,160 million (23.7 million shares at $49 per share) to $711 million (23.7 million shares at $30 per share).

Mesa filed lawsuits in both federal court and Delaware state court challenging Unocal's exchange offer and its discriminatory provision. On April 22, 1985, the United States District Court for the Central District of California postponed Unocal's annual

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[4] To cushion the drop in the price of the Unocal stock expected from the $3.6 billion increase in Unocal's debt that would result from the exchange, Unocal also announced its intention to form a master limited partnership affecting certain assets of its principal operating subsidiary, Union Oil Company of California.

meeting for two weeks; the court further found that Unocal's exclusion of Mesa from its offer did not violate federal law and was in fact a state law matter. Although the Delaware Chancery Court temporarily enjoined the offending provision, the Delaware Supreme Court on May 17, 1985 reversed the Chancery Court and upheld the exclusion of Mesa from Unocal's exchange offer.

In late April, Unocal announced that midnight, EST, May 17, 1985, would constitute the proration and withdrawal date for its exchange offer. However, wanting to end Mesa's tender offer as well as the threat of a future offer, Unocal and Mesa representatives met to discuss settlement options on May 14. Due to restrictions imposed by federal law on purchases during a tender offer or exchange offer,[5] the only mechanism available to Unocal to make a payment to Mesa and at the same time reduce Mesa's ownership interest in Unocal was the inclusion of Mesa in Unocal's exchange offer.

On May 15, Unocal proposed to include Mesa in the exchange offer and to devise a standstill agreement whereby Mesa's future role with regard to Unocal would be significantly limited. Mesa rejected Unocal's proposal. On May 17, after the Delaware Supreme Court rendered its decision against Mesa, Mesa sought to reopen discussions with Unocal. On May 20, 1985, the parties reached a settlement agreement which encompassed the following principal provisions:

(1) Mesa agreed to terminate its tender offer and to adhere to the following standstill provisions:

a) Mesa agreed for a period of twenty five years not to participate in any proxy solicitation and not to acquire any additional Unocal shares;

b) Mesa agreed for a period of ten years to vote its Unocal stock on all matters in the same way and in the same proportion as those held by non-Mesa shareholders;

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[5] *See* 17 CFR 240.10b-13.

c) Mesa agreed to strict controls upon the sale of its Unocal stock.

(2) In return, Mesa would be allowed to tender its Unocal stock into the exchange offer.

The exchange provided for shareholder participation to an extent proportional to the shareholder's Unocal holdings. In exchange for its Unocal stock, a shareholder received debt securities valued at $75 per share of Unocal stock. On May 20, 1985, Mesa exchanged 7,846,705 shares of Unocal stock for nonconvertible debt securities. In light of the participation of other shareholders on a proportional basis, Mesa's ownership interest in Unocal after the exchange remained the same, 13.6%. On July 3, 1985, Mesa cashed out its debentures for approximately $589 million.

By letter dated November 25, 1985, a Unocal shareholder, David Colan, communicated through his lawyer to Unocal a belief that a possible violation of Section 16(b) may have resulted from Mesa's acquisition and subsequent sale of its Unocal stock. On December 17, 1985, Dennis Codon, Assistant to the General Counsel at Unocal, wrote to Mr. Colan that after an internal review and consultation with outside counsel, Unocal had concluded that Mesa had not violated Section 16(b).[6]

On June 3, 1986, David Colan filed a derivative action on behalf of Unocal Corporation alleging violations of Section 16(b) of the Securities and Exchange Act by Mesa. 15 U.S.C. 78p(b). Unocal was named as a defendant. As late as June 26, 1989, Unocal in its First Amended Answer denied that Unocal had given Mesa access to any inside information. However, in this

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[6] Specifically, Unocal stated that the one time block purchase which caused Mesa to exceed ten percent ownership was not considered a "purchase" for purposes of the "purchase" requirement under Section 16(b); therefore, Mesa's sale of Unocal stock did not create the necessary "purchase" and "sale" for imposition of Section 16(b) liability.

same document, Unocal stated that on the basis of discovery and information from the U.S. Attorney about investigations into insider trading which indicated that the principal transaction in question was not a single block trade, Unocal believed that disgorgement of profits pursuant to Section 16(b) was proper. On August 23, 1989, Unocal was realigned as a party-plaintiff.

Mesa initially raised the unorthodox transaction exception to Section 16(b) created by the Supreme Court in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 93 S.Ct. 1736, 36 L.Ed.2d 503 (1973) as an affirmative defense in its Answer filed on July 14, 1986. Subsequently, Mesa filed its Second Motion for Summary Judgment in which it asserted that none of the three key Section 16(b) elements was present in this case. In denying Mesa's motion on October 23, 1989, the Court found that genuine issues of material fact remained in dispute concerning, *inter alia,* the existence of a Section 16(b) sale. On November 3, 1989, the Court denied Mesa's Ex Parte Application to Certify this question for Interlocutory Appeal.

On December 1, 1989, Plaintiffs filed a motion seeking an order *in limine* that the unorthodox transaction exception did not apply in this case. In conjunction with other *in limine* motions, this question came before the Court for hearing on January 4, 1990. At the hearing, Mesa renewed its request that the Court reconsider its Second Motion for Summary Judgment as it relates to the unorthodox transaction exception. At the same time, Plaintiffs requested that the Court consider their *in limine* motion as a cross-summary judgment motion on this issue. All parties agreed that the facts were fully developed in the present record so that the Court could decide this issue as a question of law. On the basis of this representation, the Court took the two motions for summary judgment under submission on January 4, 1990.

The Court considered the two motions as cross motions for summary judgment. The Court reviewed and considered all papers which were filed in conjunction with Plaintiffs' *in limine* motion and again reviewed and considered Mesa's Second Summary Judgment Motion, as well as all pleadings and all other

papers filed in this action. On January 19, 1990, the Court issued an Order granting Defendant's Motion for Summary Judgment and denying Plaintiff's Cross-Motion for Summary Judgment. In so holding, the Court found that Mesa's tender of its Unocal stock in the May 1985 exchange was an unorthodox transaction to which Section 16(b) liability did not attach.

On January 26, 1990, a status conference was held to determine the extent, if any, to which the January 19, 1990 Order was dispositive of the case. Mesa argued that since there was no applicable Section 16(b) sale, Plaintiffs could not state a claim upon which relief could be granted and therefore the case should be dismissed. Plaintiffs responded that although they respectfully disagreed with the merits of the Court's ruling, the Order itself did not dispose of the second event which might be considered a sale under Section 16(b): Mesa's conversion of the debt securities, received in exchange for its Unocal stock, into cash in July 1985. Since neither party had adequately addressed the July 1985 transaction in its motion, the Court requested additional briefing on this issue.

The parties have since submitted addendums to their original briefing papers. The Court construes these supplemental papers as part of the previously filed Cross-Motions for Summary Judgment. In essence, Plaintiffs assert that either the May 1985 exchange or Mesa's conversion of its debt securities for cash in July 1985 must be a sale pursuant to Section 16(b). Mesa submits that the May 1985 exchange is an unorthodox transaction which is not susceptible to Section 16(b) liability. Since Mesa sold its stock in an unorthodox transaction in May 1985, the Court need not examine subsequent events since Mesa could not have sold the same stock twice. In any event, Mesa asserts that Plaintiffs' claim based upon the July 1985 transaction is time-barred. Mesa further argues that this claim fails as a matter of law because transactions involving debt securities do not fall within the purview of Section 16(b).

In this case, both Plaintiffs and Defendants moved for summary judgment as a matter of law on facts which they agreed

were not in dispute. The principal question initially presented to the Court in the cross-motions concerned the application of the *Kern* exception to the May 1985 exchange. When the potentially dispositive nature of the cross-motions became clear in light of the Court's ruling in favor of Defendants, Plaintiffs directed the Court's attention to the July 1985 transaction. The Court has now considered both events to determine whether on the facts of this case a Section 16(b) sale exists as a matter of law.

Based on this review, the Court finds that Mesa's tender of its Unocal stock to Unocal in exchange for debt securities in May 1985 was an unorthodox transaction. In applying the *Kern* exception to the May transaction, the Court finds that although Mesa sold its Unocal stock within six months of its purchase, the sale is exempt from Section 16(b) liability. Such a finding precludes the need for the Court to consider subsequent events which absent the May sale might have provided the basis for a Section 16(b) sale.

Nevertheless, the Court proceeds to address the merits of the July 1985 transaction. Liberally interpreting Plaintiffs' Complaint, the Court finds that Plaintiffs' claim of liability premised upon the July 1985 conversion of debt securities into cash is not time-barred. However, as a matter of law, the Court cannot find that the July 1985 conversion is a Section 16(b) sale. Accordingly, the Court grants Defendants' Motion for Summary Judgment and denies Plaintiffs' Cross-Motion for Summary Judgment.

This Order replaces the January 19, 1990 Order Re: Cross-Motions for Summary Judgment. The present Order governs in this case. The Court deems the previous ruling on these cross-motions to be without force and effect.

STANDARD OF PROOF

"It is well settled that the filing of cross-motions for summary judgment, both parties asserting that there are no contested issues of material fact, does not vitiate the court's responsibility to

determine whether disputed issues of material fact are present. A summary judgment cannot be granted if a genuine issue as to any material fact exists." *United States v. Fred. A. Arnold, Inc.*, 573 F.2d 605, 606 (9th Cir. 1978). However, if a decision is to be reached by a court, and there are no issues of witness credibility, the court may conclude on the basis of affidavits, depositions, and other evidence that there are no genuine issues of material fact in dispute, even though the decision may depend on inferences to be drawn from what has incontrovertibly been proven. *Nunez v. Superior Oil Co.*, 572 F.2d 1119, 1123-24 (5th Cir. 1979).

Interpretation of a statute is appropriate for adjudication as a matter of law if all the facts before a court are undisputed. *See Smith v. Califano*, 597 F.2d 152, 155 (9th Cir 1979), *cert. denied*, 444 U.S. 980. The definition of the term "sale" and its application to a particular set of facts is like any other question of statutory construction, a question of law. *See e.g. Kern County Land Co.*, supra.

When both parties cross move on the same legal theory, a court's granting of one party's motion entails the denial of the adversary's motion. *See Schlycter v. Baker*, 580 F.2d 848, 849 (5th Cir. 1978). Since all the evidentiary facts are now before the Court, an interpretation of those facts in the process of determining the application of Section 16(b) as a question of law is appropriate in considering these summary judgment motions. *See Nunez v. Superior Court*, supra at 1123.

DISCUSSION

For the purpose of preventing the unfair use of information which may have been obtained by reason of a person's relationship to the issuing corporation, Section 16(b) of the Securities Exchange Act of 1934 provides that officers, directors, and holders of more than 10 percent of the listed stock of an issuing company shall be liable to the company for any profits realized from any purchase and sale or sale and purchase occurring within a period of six months. 15 U.S.C. (78p(b). Section 16(b) "was

designed to discourage corporate insiders from reaping profits from fluctuations in the price of the corporation's stock, that were predictable on the basis of inside information." *Provident Securities Co. v. Foremost-McKesson*, 506 F.2d 601, 604 (9th Cir. 1974), *aff'd* 423 U.S. 232, 96 S.Ct. 508, 46 L.Ed 2d 464 (1976).

Determination of Section 16(b) liability is premised on an objective test: If a sale and purchase by a ten percent shareholder results in a net gain, the gain is recoverable. *Arrow Distributing Corp. v. Baumgartner*, 783 F.2d 1274, 1281 (5th Cir. 1986). The short swing trader must disgorge any profits without proof of actual abuse of inside information and without proof of intent to profit on the basis of such information. *Kern County*, 44 U.S. at 595. If a transaction falls within the literal terms of the statute, liability is automatic. *Gund v. First Florida Banks, Inc.*, 726 F.2d 682, 686-87 (11th Cir. 1984); *Kay v. Scientex*, 719 F.2d 1009, 1013 (9th Cir. 1983).

In drafting Section 16(b), Congress "recognized that short-swing speculation by stockholders with advance, inside information would threaten the goal of the Securities Exchange Act to 'insure the maintenance of fair and honest markets'. *Kern County*, supra at 1743 citing 15 U.S.C. sec. 78b. Congress deemed the stringent requirements of Section 16(b) necessary to eliminate undue problems of proof and to have a general rule to take all possible profit out of those transactions in which the possibility of abuse was intolerably great. *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422, 92 S.Ct. 596, 599, 30 L.Ed.2d 575 (1972).

Despite the mandatory language of Section 16(b), the Supreme Court in *Kern County* recognized that "courts have wrestled with the question of inclusion or exclusion of certain 'unorthodox' transactions." 93 S.Ct. at 1744. "Transactions which on their face do not clearly involve a purchase and a sale and which therefore require analysis ... to determine if the possibility for speculative abuse exists, have been described as 'unorthodox'." *Portnoy v. Memorex Corp.*, 667 F.2d 1281, 1285 (9th Cir. 1982) (Reinhardt, Chief Judge, Concurring). To

account for these unorthodox transactions and to prevent an overly broad interpretation of Section 16(b), the Supreme Court adopted a more "pragmatic approach" to the application of the statute. *Kern County Land Co.*, supra at 1744.

In *Kern County*, the Supreme Court stated in pertinent part:

> In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction [served] as a vehicle for the evil which Congress sought to prevent — the realization of short-swing profits based upon access to inside information — thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits.

Id. at 1744-45. In light of the strict terms of the statute, where alternative constructions of the terms of Section 16(b) are possible, the statute should be applied only where its application would serve Congress' goals. *Id.*, at 1745. Thus, Section 16(b) is applied automatically only to 'orthodox' transactions as defined by case law; unorthodox transactions are actionable under Section 16(b) only if a court's pragmatic analysis demonstrates that the transaction presented an opportunity for speculative abuse.

I. The May 1985 Unocal Exchange Offer

In *Kern County*, the Supreme Court established a two part test to determine the applicability of Section 16(b) liability to a purported sale: (1) Was the stock "sold" in an unorthodox transaction?[7] and (2) Was there any opportunity for the party to

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[7] It appears that to be a sale under Section 16(b), there must be some change in either the character of the investment or the nature of the market risk assumed. *Rothenburg v. United Brands Co.*, [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) 96,045 (S.D.N.Y. 1977). There is little question that the risk associated with Mesa's Unocal investment, and the nature of the investment itself, changed after Mesa exchanged its stock for debt securities. In this case, however, the question is not whether Mesa sold its Unocal stock in May 1985, but rather whether the stock was sold in an unorthodox transaction.

engage in the kind of speculative abuse of inside information which Section 16(b) was designed to prevent? *Id.* at 1744-45. A finding that the Mesa-Unocal exchange was in fact an unorthodox transaction would in essence dispose of the case since there would be no applicable sale to which section 16(b) liability could attach.

A simple cash for stock transaction is "clearly within the purview of [section] 16(b)". *Kern County*, 411 U.S. at 593. Transactions which have been found to be unorthodox include "stock conversions, exchanges pursuant to mergers and other corporate reorganizations, stock reclassifications, and dealings in options, rights, and warrants." *Id.* citing 2 L. Loss, *Securities Regulation* 1069 (2d ed. 1961). Although the Ninth Circuit has determined that this list is not all inclusive, the Court has not applied the *Kern* exception to transactions which are essentially cash for stock and orthodox in all other respects. *See Provident Securities Co. v. Foremost-McKesson*, supra at 604-605 (The court found "no meaningful distinction between consideration in the form of cash and consideration in the form of corporate assets.").

Any mechanical application of Section 16(b) is limited to "garden variety transaction[s]". *Whittaker v. Whittaker*, 639 F.2d 516, 523 (9th Cir.), *cert. denied*, 454 U.S. 1031 (1981). The fact that stock is exchanged for cash or a cash equivalent within six months, however, is not determinative of the question of unorthodoxy. The critical issue is not the form of consideration paid for the stock but rather the nature of the disposition of the stock. *See Colan v. Prudential-Bache Sec. Inc.*, 577 F. Supp. 1074, 1082 (N.D.Ill. 1983). Similarly, profit is not in and of itself an indication of Section 16(b) liability.

Unocal claims that Mesa exchanged its stock for a cash equivalent — debt securities — which were immediately convertible into cash. Mesa responds that its sale of Unocal stock pursuant to a settlement agreement was part of a corporate reorganization which was an unorthodox transaction.

The Unocal exchange offer was a type of corporate reorganization commonly described as a recapitalization. A recapitalization is in essence a "reshuffling of a capital structure, within the framework of an existing corporation." *Helvering v. Southwest Consol. Corp.*, 315 U.S. 194, 202, 62 S.Ct. 546, 552, 86 L.Ed. 789 (1942). Commentators have generally classified exchange offers as a type of corporate recapitalization:

> A recapitalization may . . . be structured as an exchange offer in which the company offers to purchase a certain number of its shares in exchange for cash or debt securities. The transactions involving Phillips Petroleum, Unocal, and Union Carbide are the most celebrated examples of this structure. Notably, this structure has been largely used in response to hostile tender offers.

Ledderman & Goroff, *Recapitalization Transactions*, 19 Rev. Sec. & Commodities Reg. (1986).[8] In at least one case, *Rothenburg v. United Brands Co.*, a court has held that an exchange of stock in a recapitalization following a tender offer was not a sale pursuant to Section 16(b). [1977-1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) 96,045 (S.D.N.Y. 1977).

Mesa's tender of its Unocal stock for debt securities in response to Unocal's exchange offer was not a garden variety stock for cash transaction. In this case, Mesa's "sale" of its Unocal stock was in response to Unocal's direct solicitation for the stock. Mesa's stock was tendered in conjunction with other Unocal shareholders and in the same proportion. Absent Unocal's consent to Mesa's

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[8] *See also* A. Fleisher, 1 *Tender Offers: Defenses, Responses and Planning*, 388.172 (Supp. 1987) ; Block & Hoff, *Recapitalizations and Restructurings* 186, reprinted in Block & Radin, *The Business Judgment Rule in Derivative and Corporate Takeover Litigation*, Hostile Battles for Corporate Control 1989 (PLI Corporate Law & Practice Series No. 633, 1989); Nathan & Sobel, *Corporate Stock Repurchases in the Context of Unsolicited Takeover Bids*, 35 Bus.Law. 1545 (July 1980); Fogelson, *Recent Takeover Defense Strategies*, Hostile Battles for Corporate Control 1986 at 467 (PLI Corporate Law & Practice Series No. 513, 1986).

participation in the exchange offer, Section 16(b)'s six month provision would have precluded Mesa from disposing of this stock in a more traditional sale transaction. A sale pursuant to a recapitalization of this type is outside the scope of the definition of a Section 16(b) "sale". The Court finds that Mesa's exchange of its Unocal stock for debt securities in the May 1985 exchange was an unorthodox transaction under *Kern County*; therefore, the transaction deserves closer scrutiny to determine whether the potential for abuse of inside information existed.

The potential for abuse of inside information is considered only after a transaction is found to be unorthodox or borderline. *Whittaker v. Whittaker*, 639 F.2d 516, 522 (9th Cir.), *cert. denied* 454 U.S. 1031, 102 S.Ct. 566, 70 L.Ed.2d. 473 (1981). If a transaction falls within the literal terms of the statute, it is irrelevant that the defendant actually received or used inside information. *See e.g. National Medical Enterprises, Inc. v. Small*, 680 F.2d 83, 84 (9th Cir. 1982). However, "because of the mechanical application of Section 16(b) imposing liability without fault on transactions within its scope, courts more recently have been hesitant to bring borderline transactions under that scope . . . where congressional intent is unclear and the transaction in question was not of a type giving rise to speculative abuse." *Whittaker v. Whittaker.*, supra at 522; *See also Blau v. Lamb*, 363 F.2d 507, 516 (2d Cir. 1966).

Congress adopted Section 16(b) to prevent insiders of publicly held corporations, who had advance knowledge of facts or access to information not available to other investors that, upon public disclosure, would produce either a rise or fall in the market price of the stock, from realizing a personal profit by buying or selling the corporation's shares before the good or bad news was made public. *Reliance Electric Co. v. Emerson Elec. Co.*, 404 U.S. 418, 92 S.Ct. 596, 599 (1972); *Arrow Distributing Corp.*, supra at 1277. The Ninth Circuit has defined inside information for Section 16(b) purposes as "the kind of information that is commonly reserved for company management and is thus the type of information that would 'aid [one] if he engaged in

personal market transactions.' " *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Livingston*, 566 F.2d 1119, 1123 (9th Cir. 1978).

In determining whether a transaction has the potential for speculative abuse, a court must look at two factors: 1) Could the defendant reasonably be expected to have had access to inside information? and 2) Did the defendant initiate the transaction voluntarily? *Provident Securities Co. v. Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974) citing *Kern County*, supra at 596-600. Contrary to Mesa's contention, the Court must focus not on Mesa's literal access to inside information, but rather on Mesa's potential for speculative abuse of inside information. *Provident Securities*, supra at 605. A hostile relationship may justify the conclusion that there was only a remote possibility of access to inside information. *See e.g. Kern Co.; American Standard Inc. v. Crane Co.*, 510 F.2d 1043 (2d Cir. 1974), *cert. denied* 421 U.S.(1975).[9]

Unocal claims that Mesa had access to important information not available to the general public regarding, *inter alia*, the various actions it intended to take in buying and selling the Unocal stock, the timing of such actions, and the status and likely outcome of its negotiations with Unocal. By initiating a tender offer, Unocal contends that Mesa caused Unocal to pursue a financial policy from which Mesa benefited.

However, on the facts of this case, Mesa was a true outsider despite its ten percent stockholder status. Both Mesa and Unocal have admitted that "unmitigated hostility" characterized the relationship between the two parties. Such hostility alone may negate the existence for potential of speculative abuse. *See Kern*, supra at 598; *Crane*, supra at 1054. Furthermore, when Unocal

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[9] However, some courts have found that voluntary exchanges of stock for cash or cash equivalents may be subject to Section 16(b) regardless of "unmitigated hostility" or actual access to inside information. *Texas Int'l Airlines*, 714 F.2d 533, 538-40 (5th Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984); *Bunker Ramo-Eltra Corp. v. Fairchild Indus.*, 639 F.Supp. 409, 418 (D.Md. 1986).

was still a defendant in this case, Unocal denied that Mesa had any access to inside information.

Mesa was not privy to any information which was not generally available to other Unocal shareholders. Full disclosure was made to Unocal's shareholders regarding Mesa's tender offer and Unocal's counter exchange offer. The information which Mesa received was in no way increased by its making a tender offer. *See American Standard, Inc. v. Crane Co.*, supra at 1054. In light of the hostility between Mesa and Unocal, Mesa had no "unfair advantage" over other shareholders. *Pay Less Drug Stores*, 579 F.Supp. at 1401. In fact, the "sharpness of an open contest for control would make [Mesa] even more an adversary." *American Standard, Inc. v. Crane Co.*, supra at 1055. Thus, there is no evidence that inside information was available to Mesa by virtue of its stock ownership or that Mesa had the potential for speculative abuse of inside information. *Kern County*, supra; *see also Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 237, 96 S.Ct. 508, 513, 516, 46 L.Ed.2d. 503 (1976).

Courts have also traditionally required a showing that a transaction was involuntary in order to justify the application of the *Kern* exception.[10] In adopting this standard, the Ninth Circuit has specified that "[i]mplicit in the [requirement of voluntariness] is the limitation that the *Kern County* rule of leniency should not be applied where the defendant could have avoided

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[10] Most courts have interpreted *Kern County* to require that a sale be involuntary in order to be unorthodox. *See Kay v. Scientex Corp.*, 719 F.2d 1009, 1013 (9th Cir. 1983); *Texas Int'l Airlines v. National Airlines*, 714 F.2d 533, 540 (5th Cir. 1983) (under *Kern*, voluntary transactions should not be found to be unorthodox); *Tyco Laboratories, Inc. v. Cutler-Hammer, Inc.*, 490 F.Supp. 1, 6 (S.D.N.Y. 1980) (for *Kern* exception to apply, transaction must be involuntary). *But see Pay Less Drug Stores v. Jewel Cos.*, 579 F. Supp. 1396 (N.D.Cal. 1984) (voluntary decision to exercise option for cash was an unorthodox transaction because it was not based upon inside information which insider could use to gain an unfair advantage over other shareholders).

section 16(b) liability without serious detriment." *Provident Securities,* supra at 605.

In the context of Section 16(b), involuntariness generally requires an inability of the unsuccessful party to control the terms, conditions, and timing of a sale. *See Heublein, Inc. v. Gen'l Cinema Corp.,* 559 F.Supp. 692, 699-700 (S.D.N.Y.), *aff'd* 722 F.2d 29 (2d Cir. 1983), *cert. denied* 465 U.S. 1066 (1984). As long as a seller retains any control over whether or when a transaction takes place, the sale is voluntary. *Sprague Electric Co. v. Mostek Corp.*, 488 F.Supp. 842, 845 (N.D.Tex. 1980). In *Sprague*, the court specifically noted that had the defendant sold his stock pursuant to a stockholders' agreement, which would have essentially deprived the stockholder of his control, the sale would have been involuntary.

The key factor is whether the insider can control the transaction, "not whether the insider has any control over *any method* of disposing of his stock. *See* A. Jacobs, *Section 16 of the Securities Exchange Act*, 3-136 to 3-137 (1989)(emphasis in original). Even though the Supreme Court labeled the transaction in *Kern County* involuntary, the Court recognized that Occidental had an alternative, ie. selling the stock for cash prior to the merger; however, the Court held that this was not a "realistic alternative" since the defendant would have been subject to Section 16(b). 411 U.S. at 600. Other courts have placed similar emphasis on the quality of an insider's choice. *See Heublein, Inc. v. General Cinema Corp.* 559 F.Supp. 692, 699-700 (S.D.N.Y.), *aff'd*, 722 F.2d 29 (2d Cir. 1983), *cert. denied*, 465 U.S. 1066 (1984) ("once the merger was approved, General Cinema, like Occidental in *Kern County*, was left with no viable alternatives"); *Abrams v. Occidental Petroleum Corp.*, 450 F.2d 157 (2d Cir. 1971), *aff'd*, 411 U.S. 582 (1973) (discussing "economically forced exchange" in connection with the pragmatic analysis to determine purchase or sale); *Colan v. Prudential-Bache Sec. Inc.*, 577 F.Supp. 1074, 1083 (N.D.Ill. 1983) (merger gave insider "no real choice").

In some cases, an otherwise voluntary transaction may be deemed involuntary if the defendant would have suffered serious economic loss had the transaction not taken place. Mesa's desire to participate in Unocal's exchange offer did not simply result from a decision that it was too unprofitable to pursue the proxy contest. Mesa's stock holdings would have seriously declined in value, approximately $450 million, if it had not negotiated with Unocal to exchange its shares. *Cf. Lane Bryant, Inc. v. Hatleigh Corp.*, 517 F.Supp. 1196, 1200 (S.D.N.Y. 1981) (since defendant simply decided the proxy contest was too costly, the court found that the *Kern* exception did not apply to the sale of defendant's stock).[11]

In an action brought by a tender offeror to enjoin the target corporation from pursuing a self tender, the Delaware Chancery Court found that a technically optional recapitalization in the form of a self-tender by a company defending against a takeover attempt was coercive because no rational shareholder could afford not to tender in light of the disparity between the self-tender price and the anticipated post-recapitalization value of the remaining shares; as a result, the Delaware court concluded that a shareholder "acting with economic rationality [had] no effective choice" but to participate in the recapitalization. *AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 113-14 (Del. Ch. 1986). Similarly, the structure of Unocal's exchange offer rendered Mesa's participation therein financially necessary in substance even though it was voluntary in form. *cf. City Capital Assoc. v. Interco, Inc.*, 551 A.2d 787, 797 (Del. Ch. 1988).

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[11] Plaintiffs argue that Mesa would have been able to turn its paper loss into a $532 million profit by December 1989 if Mesa had held on to its Unocal stock. However, the fact that this loss may have been recovered by Mesa if Mesa had pursued its Unocal investment is not relevant to an analysis of voluntariness. The Court must be concerned with the facts as they existed at the time Mesa had to decide whether to participate in the exchange.

Unocal initiated the exchange offer as a defensive tactic to extricate Mesa from Unocal. Several lawsuits resulted because Unocal chose to exclude Mesa from the exchange offer. After the Delaware Supreme Court placed its imprimatur on Unocal's exclusion of Mesa, Unocal instead chose to pursue a settlement agreement with Defendants. Absent Unocal allowing Mesa to participate in the exchange, Mesa would have been excluded.

By virtue of Unocal's attempt to exclude Mesa from participating in its exchange offer and ultimately the courts' approval of this exclusion, Mesa was faced with the prospect of huge economic losses. Unless Mesa was able to tender its Unocal stock as part of the exchange offer, Mesa risked the loss of up to $450 million. Mesa did not possess the alternative of selling to another buyer since such a sale would clearly have been prohibited by Section 16(b). Simply holding the stock was not a reasonable alternative. Furthermore, while Mesa willingly tendered its Unocal stock for debt securities, Mesa had no control over its ability to participate in the exchange. Unocal had the power to exclude Mesa at will. Although Mesa sought to participate in the exchange offer, Mesa's role was in essence involuntary.[12]

Mesa's exchange of its Unocal stock pursuant to the settlement agreement with Unocal was not a "garden variety" cash for stock transaction. The sale was part of an overall recapitalization initiated by Unocal. Mesa did not benefit from the use of inside information and had no potential for speculative abuse of inside information. Although Mesa's tender of its Unocal stock in exchange for debt securities can be considered a "sale", the Court

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[12] Plaintiffs contend that statements by T. Boone Pickens in his book *Boone* are the best evidence that Mesa had alternatives. Plaintiffs assert that such admissions are dispositive on the issue of voluntariness. The Court, however, finds the contrary. Mr. Pickens' statements reflect the belief that Mesa had the potential both to gain and to lose significant money. In light of the self-aggrandizement in which Mr. Pickens partakes, the Court treats his admissions accordingly. In sum, the facts in this case support a finding that Mesa's participation in the Unocal exchange was essentially involuntary.

finds that the *Kern County* unorthodox transaction exception applies to the May 1985 exchange offer to exempt it from Section 16(b) liability.

II. The July 1985 Conversion Of Debt Securities Into Cash

There is no question that Mesa's "cash-out" of its debentures was entirely voluntary. Furthermore, it is clear that this transaction occurred within six months of the March stock purchases that put Mesa over the 10% ownership mark. Since neither party contends that this event was or was not an unorthodox transaction, any liability premised on this transaction depends entirely upon the straight application of Section 16(b).[13]

As a threshold matter, however, the Court must determine whether this claim is time-barred, as Defendants contend. Mesa argues that Plaintiffs' matching of the conversion of the debt securities with Mesa's purchase of its Unocal stock to establish Section 16(b) liability is a new cause of action which has not been previously pled. Section 16(b) expressly provides that "no . . . suit shall be brought more than two years after the date such profit was realized." 15 U.S.C. sec. 78p(b). Plaintiffs respond that the allegation in their Complaint that "[w]ithin a period of less than six months in 1985, Partners, while a 10% statutory insider of Unocal, purchased and sold Unocal common stock at a substantial profit" placed Mesa on notice of the July 1985 transaction.

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[13] Mesa argues that its tender of Unocal stock in the May 1985 exchange was the sale which must be considered for the purpose of Section 16(b) liability. A finding that the exchange was an unorthodox transaction does not alter the fact that Mesa "sold" its Unocal stock. For this reason, Mesa contends that it did not possess any securities subject to Section 16(b) after this date, and thus, the Court need not address the July 1985 conversion. The Court finds this argument persuasive. However, for the purposes of providing a complete and thorough record, the Court proceeds to consider the merits of the July 1985 transaction.

Unless the Court determines that Plaintiffs' Complaint adequately encompasses the July 1985 transaction as a possible 16(b) sale, Plaintiffs' claim which is premised on this transaction is time-barred. Even if Mesa did not realize profit until July 1985, any claim based on the transaction had to be initiated by July 1987. As Plaintiffs note, the next specific reference to this transaction as an alternative basis for Section 16(b) liability occurred in October 1989.

Even if the Court determines that the Complaint adequately states a claim that the July 1985 transaction is a 16(b) sale, Defendants contend that Plaintiffs have waived this claim by their failure to incorporate it into the Pretrial Order. "[P]articular evidence or theories which are not at least implicitly included in the order are barred unless the order is first 'modified to prevent manifest injustice'." *United States v. First Nat. Bank of Circle*, 652 F.2d 882, 886-87 (9th Cir. 1981) citing Fed.R.Civ.P.16.

Plaintiffs provide five specific instances in which they raised this claim: (1) Plaintiffs' Pretrial memorandum,[14] (2) Plaintiffs' Motion in Limine,[15] (3) The Pretrial Order filed November 9,

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[14] Plaintiffs' Pretrial memorandum merely states that "[o]n July 3, 1985, Mesa received these debt securities and sold them for $589 million . . ." Plaintiffs apparently rely on their use of the word "sold" as the basis of their claim.

[15] The most direct argument that the July transaction might be an applicable 16(b) sale was presented in Plaintiffs' in limine motion on this issue. In Footnote No. 5, Plaintiffs noted:

> Mesa received the bonds on July 3, 1985 and immediately sold them for approximately $589 million . . . Thus, although the debt securities were a cash equivalent sufficient to defeat the invocation of the exception here, Mesa actually cashed in the debt securities within six months.

Then, later in the in limine motion, Plaintiffs assert:

> The "recapitalization" cases are wholly unavailing for yet another reason. In each of the five cases discussed above, the plaintiff

1989, (4) Plaintiffs' 1292(b) Opposition filed October 26, 1989, and (5) The deposition of Plaintiffs' damage expert. Plaintiffs assert that they have not waived this claim because they incorporated it into the Pretrial Order by reference. Even if the Court finds to the contrary, Plaintiffs request that the Court modify the Pretrial order pursuant to Fed. R. Civ. P. 16(e) to prevent manifest injustice.

The Pretrial Order does contain a catch-all reference to the Plaintiffs' Memorandum of Contentions. Thus, at least implicitly, the Pretrial Order refers to a document wherein Plaintiffs raise a Section 16(b) claim based upon the July 1985 transaction. In light of the congressional policy to trap valid short-swing profits, the Court should give the benefit of any doubt to a plaintiff in his or her pleading of a Section 16(b) claim. As a result, the Court concludes that the language of Plaintiffs' Complaint which refers to the purchase and sale of *stock*, which technically appears to exclude consideration of a sale of debt securities, is not determinative on this statute of limitations question.

Construing the Complaint and the Pretrial order liberally, the Court will not hold that Plaintiffs' claim that the July 1985 transaction is a section 16(b) sale is time-barred. Although Plaintiffs' Complaint can hardly be characterized as a model complaint, the Court is unwilling at this stage to dispose of the

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attempted to use the reclassification or recapitalization as either the "purchase" or "sale" necessary to establish Section 16(b) liability. (footnote omitted). In the present case, Mesa sold the debt securities for cash within six months of the date it crossed Section 16(b)'s ten percent threshold. Thus, even assuming, *arguendo*, that Mesa's change from equityholder to debtholder was merely a change of form and not substance, Mesa still went ahead and converted the bonds to cash on the day it received them, well within the six-month window. Unlike the cases cited by Mesa, the present action involves a cash purchase and a cash sale within six months, regardless of whether the exchange of stock for bonds was a Section 16(b) sale. Such transactions always fall within the ambit of Section 16(b).

claim on technical pleading grounds. For the purposes of these motions, the Court construes the Complaint to cover the July 1985 transaction since as a matter of law, Plaintiffs' attempt to apply Section 16(b) to this transaction must fail.

Assuming *arguendo* that the July 1985 claim is adequately pled and thus not time-barred, the Court now turns to the merits of this transaction as a Section 16(b) sale. Once again, the relevant facts are undisputed. On May 20, 1985, Mesa, while a ten percent shareholder, exchanged 7,846,705 shares of Unocal stock for senior notes secured by Unocal common stock worth approximately $75 per share. Mesa remained a ten percent shareholder after this exchange. On July 3, 1985, while a beneficial owner, Mesa cashed in the debentures for approximately $589 million, or $75 per share. There is no question that Mesa's decision to convert its debt holdings into cash was voluntary.

Plaintiffs now argue that the critical fact which the Court must consider is that Mesa went from a multi-million dollar equity position to cash as a result of two voluntary investment decisions within six months while a more than 10% shareholder in Unocal. Plaintiffs contend that Mesa's profit of $96.8 million is subject to Section 16(b) regardless of whether the exchange of stock for debentures in May 1985 is viewed as an unorthodox transaction and regardless of the fact that the securities which were ultimately converted into cash were debt, not equity securities. In essence, Plaintiffs urge that Mesa's interim exchange of stock for debt securities cannot exempt any short swing profits from Section 16(b).

In arguing this position, Plaintiffs seek to rearticulate the statutory provisions of Section 16(b). The plain language of Section 16(b) of the Securities and Exchange Act of 1934 provides in pertinent part:

> For the purpose of preventing unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase or sale, or any

> sale and purchase, of any *equity* security of such issuer . . . shall inure to and be recoverable by the issuer . . .

15 U.S.C. section 78p(b) (emphasis added). The term "equity security" refers to "any stock or similar security; or any security convertible, with or without consideration, into such a security . . ." 15 U.S.C. section 78(c)(11) Thus, the term does not encompass debt securities which do not display any features of convertible securities. *See also* 17 C.F.R. Ch.II section 240.3all-1 (1989).

The debt securities in this case were typical debt instruments — unqualified obligations on the part of Unocal to pay a fixed sum at a fixed maturity date along with periodic interest payments, regardless of the status of Unocal's common stock. *See United States v. Evans*, 375 F.2d 730, 731 (9th Cir. 1967). The legislative history of Section 16(b) confirms that Congress intentionally restricted the statute's coverage to exclude non-convertible debt instruments. *See e.g.*, P. Romeo & A. Dye, *Section 16 Reporting Guide*, section 7.01 [1] (1989):

> The legislative history of Section 16 reveals that the drafters originally intended to apply the provision to any person who owned more than five (later ten) percent of *any* class of securities, so long as the issuer had at least one class of securities registered on a national stock exchange. Objections to this all-inclusive provision were raised at the congressional hearings on the 1934 Act, principally on the ground that ownership of debt securities rarely gave the holder control over the issuer or its policies. Moreover, Congress appears to have recognized that transactions in pure debt securities rarely are susceptible to speculative abuse, since such securities generally trade on the basis of their inherent characteristics (*e.g.*, yield, maturity, redemption provisions, etc.) rather than in reaction to corporate developments. As a result, Congress decided to restrict the coverage of Section 16 solely to equity securities.

(emphasis in original). From the beginning, the Securities and Exchange Commission has consistently held that non-convertible

debt securities are not equity securities for section 16(b) purposes.[16]

Each of the cases cited by Plaintiffs for the proposition that a purchase of stock may be matched with a sale of debt for Section 16(b) purposes is easily distinguishable. Each involves the conversion of an equity security into another equity security or the sale of equity for cash. *See Blau v. Lamb*, 363 F.2d 507 (2d Cir. 1966); *Rothenburg v. United Brands Co.*, supra; and *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1063 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000, 95 S.Ct. 2397, 44 L.Ed.2d 667 (1975). In this case, the July 1985 transaction involved debt, not equity securities. While courts considering potential 16(b) transactions have held that an interim unorthodox transaction within the statutory six month period may be disregarded as a step in the process, *see Blau v. Max Factor & Co.*, 342 F.2d 304, 308 (9th Cir. 1965); and *Rothenburg v. United Brands Co.*, supra, the final disposition of securities in those cases still involved equity, not debt.

The length of an insider's investment commitment is not always controlling. The liquidation of an investor's stock holdings within six months does not translate automatically into Section 16(b) short-swing profits. Profits derived from two investment decisions within the statutory six month period must be disgorged only if both the "purchase" and "sale" are governed by Section 16(b). The final disposition of a security does not

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[16] *See e.g.*, Exchange Act Release No. 2575 (July 5, 1940) (none of the various debentures involved "is an 'equity' security as defined in Section 3(a)(11) . . . and, hence, Section 16 . . . would be inapplicable to transactions therein by the officers, directors, and stockholders of the respective issuers."); Exchange Act Release No. 2937 (June 19, 1941) (Section 16 inapplicable to mortgage bonds since the subject securities were not equity securities.).

become a Section 16(b) sale merely because it occurs within six months of the purchase of the original equity security.[17]

Plaintiffs' arguments are without foundation in precedent or otherwise. The Court finds that Mesa sold its Unocal stock to Unocal in exchange for debt securities in May 1985. While Mesa's investment commitment with respect to Unocal's equity securities lasted for a period of less than six months, that commitment terminated in an unorthodox transaction which carried no potential for speculative abuse. Because the Court finds this transaction to be unorthodox, any profits realized as a result of this transaction do not fall within the purview of Section 16(b).

After the May exchange, Mesa retained debentures which are not statutorily controlled to the same extent as equity securities. Consequently, when Mesa converted these debt holdings into cash, Section 16(b) did not control the transaction. In light of the clear statutory language precluding 16(b) coverage for transactions in debt, Plaintiffs' contention that the July 1985 conversion is a Section 16(b) sale must fail as a matter of law. This Court will not recharacterize a disposition of debt securities as a 16(b) sale simply because it follows an unorthodox transaction. *Cf. Portnoy v. Memorex corp.*, 667 F.2d 1281, 1284 (9th Cir. 1982) (refusing to recharacterize a transaction to impose Section 16(b) liability without specific congressional authority).

Plaintiffs' argument that Mesa's unclean hands precludes consideration of the purported equities in Mesa's favor is misplaced. Profit as a corporate goal and questionable takeover tactics are not the "evils" which Section 16(b) addresses. "If there are evils to

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[17] The Court does not consider the SEC regulations to be persuasive. While the Commission has the authority to exempt from Section 16(b) specific transactions that the SEC considers beyond the comprehension of the statute, the SEC's failure to address every conceivable transaction does not render those unaddressed automatically susceptible to 16(b). These rules are intended to narrow rather than broaden the scope of Section 16(b).

be redressed by way of deterring those who would make tender offers, [section] 16(b) does not appear . . . to have been designed for this task." *Kern County*, supra at 1746.

Thus, for all of the reasons explained herein, the Court finds that neither the May 20, 1985 exchange nor the July 3, 1985 conversion of debt securities into cash was a sale within the meaning of Section 16(b). Since Plaintiffs cannot establish a sale for the purpose of Section 16(b) liability, they cannot sustain their claim against Defendants. Accordingly, the Court grants Defendants' Motion for Summary Judgment and denies Plaintiffs' Cross-Motion for Summary Judgment.

IT IS SO ORDERED.

Dated: April 10, 1990

/s/ JOHN G. DAVIES

John G. Davies
United States District Judge

Appendix C

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

DAVID COLAN,
Plaintiff,
UNOCAL CORPORATION,
Plaintiff/Appellant,
vs.
MESA PETROLEUM CO., *et. al.*,
Defendant/Appellee,

CA# 90-55641
DC# CV-89-02901-JPV

DAVID COLAN,
Plaintiff/Appellant,
vs.
MESA PETROLEUM CO., *et al.*,
Defendant/Appellee,

CA# 90-55643
DC# CV-89-02901-JPV
ORDER

BEFORE: ALARCON, Circuit Judge

The motion for stay of mandate until January 31, 1992 is Granted.

Appendix D

[Full text of § 16(a), (b), 15 U.S.C. 78p(a), (b)]

(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78*l* of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 78*l*(g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the

issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

Appendix E

Excerpts from *Kern County*

Congress recognized that short-swing speculation by stockholders with advance, inside information would threaten the goal of the Securities Exchange Act to "insure the maintenance of fair and honest markets." 411 U.S. at 591.

In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent — the realization of short-swing profits based upon access to inside information — thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits. 411 U.S. at 594-95 (footnote omitted).

[D]id the exchange involve a "sale" of Old Kern shares within the meaning of § 16(b)? We agree with the Court of Appeals that it did not, for we think it totally unrealistic to assume or infer from the facts before us that Occidental either had or was likely to have access to inside information, by reason of its ownership of more than 10% of the outstanding shares of Old Kern, so as to afford it an opportunity to reap speculative, short-swing profits from its disposition within six months of its tender-offer purchases. 411 U.S. at 596.

There is no basis for finding that, at the time the tender offer was commenced, Occidental enjoyed an insider's opportunity to acquire information about Old Kern's affairs. 411 U.S. at 596-97.

If its takeover efforts failed, it is argued, Occidental knew it could sell its stock to the target company's merger partner at a substantial profit. Calculations of this sort, however, whether speculative or not and whether fair or unfair to other stockholders or to Old Kern, do not represent the kind of speculative abuse at which the statute is aimed, for they could not have been based on inside information obtained from substantial stockholdings that did not yet exist. Accepting both that Occidental made this very

prediction and that it would recurringly be an accurate forecast in tender-offer situations, we nevertheless fail to perceive how the fruition of such anticipated events would require, or in any way depend upon, the receipt and use of inside information. 411 U.S. at 597 (footnote omitted).

We are quite unconvinced, however, that the situation had changed materially with respect to the possibilities of speculative abuse of inside information by Occidental. 411 U.S. at 598.

The possibility that Occidental had, or had the opportunity to have, any confidential information about Old Kern before or after May 11, 1967, seems extremely remote. 411 U.S. at 598.

There is, therefore, nothing in connection with Occidental's acquisition of Old Kern stock pursuant to its tender offer to indicate either the possibility of inside information being available to Occidental by virtue of its stock ownership or the potential for speculative abuse of such inside information by Occidental. 411 U.S. at 599.